

**MINORITY STAFF OF THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
REPORT ON
CORRESPONDENT BANKING:
A GATEWAY FOR MONEY LAUNDERING**

February 5, 2001

U.S. banks, through the correspondent accounts they provide to foreign banks, have become conduits for dirty money flowing into the American financial system and have, as a result, facilitated illicit enterprises, including drug trafficking and financial frauds. Correspondent banking occurs when one bank provides services to another bank to move funds, exchange currencies, or carry out other financial transactions. Correspondent accounts in U.S. banks give the owners and clients of poorly regulated, poorly managed, sometimes corrupt, foreign banks with weak or no anti-money laundering controls direct access to the U.S. financial system and the freedom to move money within the United States and around the world.

This report summarizes a year-long investigation by the Minority Staff of the U.S. Senate Permanent Subcommittee on Investigations, under the leadership of Ranking Democrat Senator Carl Levin, into correspondent banking and its use as a tool for laundering money. It is the second of two reports compiled by the Minority Staff at Senator Levin's direction on the U.S. banking system's vulnerabilities to money laundering. The first report, released in November 1999, resulted in Subcommittee hearings on the money laundering vulnerabilities in the private banking activities of U.S. banks.¹

I. Executive Summary

Many banks in the United States have established correspondent relationships with high risk foreign banks. These foreign banks are: (a) shell banks with no physical presence in any country for conducting business with their clients; (b) offshore banks with licenses limited to transacting business with persons outside the licensing jurisdiction; or (c) banks licensed and regulated by jurisdictions with weak anti-money laundering controls that invite banking abuses and criminal misconduct. Some of these foreign banks are engaged in criminal behavior, some have clients who are engaged in criminal behavior, and some have such poor anti-money laundering controls that they do not know whether or not their clients are engaged in criminal behavior.

These high risk foreign banks typically have limited resources and staff and use their correspondent bank accounts to conduct operations, provide client services, and move funds. Many deposit all of their funds in, and complete virtually all transactions through, their

¹ See "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (November 9 and 10, 1999), Minority Staff report at 872.

correspondent accounts, making correspondent banking integral to their operations. Once a correspondent account is open in a U.S. bank, not only the foreign bank but its clients can transact business through the U.S. bank. The result is that the U.S. correspondent banking system has provided a significant gateway into the U.S. financial system for criminals and money launderers.

The industry norm today is for U.S. banks² to have dozens, hundreds, or even thousands of correspondent relationships, including a number of relationships with high risk foreign banks. Virtually every U.S. bank examined by the Minority Staff investigation had accounts with offshore banks,³ and some had relationships with shell banks with no physical presence in any jurisdiction.

High risk foreign banks have been able to open correspondent accounts at U.S. banks and conduct their operations through their U.S. accounts, because, in many cases, U.S. banks fail to adequately screen and monitor foreign banks as clients.

The prevailing principle among U.S. banks has been that any bank holding a valid license issued by a foreign jurisdiction qualifies for a correspondent account, because U.S. banks should be able to rely on the foreign banking license as proof of the foreign bank's good standing. U.S. banks have too often failed to conduct careful due diligence reviews of their foreign bank clients, including obtaining information on the foreign bank's management, finances, reputation, regulatory environment, and anti-money laundering efforts. The frequency of U.S. correspondent relationships with high risk banks, as well as a host of troubling case histories uncovered by the Minority Staff investigation, belie banking industry assertions that existing policies and practices are sufficient to prevent money laundering in the correspondent banking field.

For example, several U.S. banks were unaware that they were servicing respondent banks⁴ which had no office in any location, were operating in a jurisdiction where the bank had no license to operate, had never undergone a bank examination by a regulator, or were using U.S. correspondent accounts to facilitate crimes such as drug trafficking, financial fraud or Internet gambling. In other cases, U.S. banks did not know that their respondent banks lacked basic fiscal controls and procedures and would, for example, open accounts without any account opening documentation, accept deposits directed to persons unknown to the bank, or operate without written anti-money laundering procedures. There are other cases in which U.S. banks lacked

²The term "U.S. bank" refers in this report to any bank authorized to conduct banking activities in the United States, whether or not the bank or its parent corporation is domiciled in the United States.

³The term "offshore bank" is used in this report to refer to banks whose licenses bar them from transacting business with the citizens of their own licensing jurisdiction or bar them from transacting business using the local currency of the licensing jurisdiction. See also the International Narcotics Control Strategy Report issued by the U.S. Department of State (March 2000)(hereinafter "INCSR 2000"), "Offshore Financial Centers" at 565-77.

⁴The term "respondent bank" is used in this report to refer to the client of the bank offering correspondent services. The bank offering the services is referred to as the "correspondent bank." All of the respondent banks examined in this investigation are foreign banks.

information about the extent to which respondent banks had been named in criminal or civil proceedings involving money laundering or other wrongdoing. In several instances, after being informed by Minority Staff investigators about a foreign bank's history or operations, U.S. banks terminated the foreign bank's correspondent relationship.

U.S. banks' ongoing anti-money laundering oversight of their correspondent accounts is often weak or ineffective. A few large banks have developed automated monitoring systems that detect and report suspicious account patterns and wire transfer activity, but they appear to be the exception rather than the rule. Most U.S. banks appear to rely on manual reviews of account activity and to conduct limited oversight of their correspondent accounts. One problem is the failure of some banks to conduct systematic anti-money laundering reviews of wire transfer activity, even though the majority of correspondent bank transactions consist of incoming and outgoing wire transfers. And, even when suspicious transactions or negative press reports about a respondent bank come to the attention of a U.S. correspondent bank, in too many cases the information does not result in a serious review of the relationship or concrete actions to prevent money laundering.

Two due diligence failures by U.S. banks are particularly noteworthy. The first is the failure of U.S. banks to ask the extent to which their foreign bank clients are allowing other foreign banks to use their U.S. accounts. On numerous occasions, high risk foreign banks gained access to the U.S. financial system, not by opening their own U.S. correspondent accounts, but by operating through U.S. correspondent accounts belonging to other foreign banks. U.S. banks rarely ask their client banks about their correspondent practices and, in almost all cases, remain unaware of their respondent bank's own correspondent accounts. In several instances, U.S. banks were surprised to learn from Minority Staff investigators that they were providing wire transfer services or handling Internet gambling deposits for foreign banks they had never heard of and with whom they had no direct relationship. In one instance, an offshore bank was allowing at least a half dozen offshore shell banks to use its U.S. accounts. In another, a U.S. bank had discovered by chance that a high risk foreign bank it would not have accepted as a client was using a correspondent account the U.S. bank had opened for another foreign bank.

The second failure is the distinction U.S. banks make in their due diligence practices between foreign banks that have few assets and no credit relationship, and foreign banks that seek or obtain credit from the U.S. bank. If a U.S. bank extends credit to a foreign bank, it usually will evaluate the foreign bank's management, finances, business activities, reputation, regulatory environment and operating procedures. The same evaluation usually does not occur where there are only fee-based services, such as wire transfers or check clearing. Since U.S. banks usually provide cash management services⁵ on a fee-for-service basis to high risk foreign banks and infrequently extend credit, U.S. banks have routinely opened and maintained correspondent accounts for these banks based on inadequate due diligence reviews. Yet these are the very banks that should be carefully scrutinized. Under current practice in the United States, high risk foreign

⁵Cash management services are non-credit related banking services such as providing interest-bearing or demand deposit accounts in one or more currencies, international wire transfers of funds, check clearing, check writing, or foreign exchange services.

banks in non-credit relationships seem to fly under the radar screen of most U.S. banks' anti-money laundering programs.

The failure of U.S. banks to take adequate steps to prevent money laundering through their correspondent bank accounts is not a new or isolated problem. It is longstanding, widespread and ongoing.

The result of these due diligence failures has made the U.S. correspondent banking system a conduit for criminal proceeds and money laundering for both high risk foreign banks and their criminal clients. Of the ten case histories investigated by the Minority Staff, numerous instances of money laundering through foreign banks' U.S. bank accounts have been documented, including:

- laundering illicit proceeds and facilitating crime by accepting deposits or processing wire transfers involving funds that the high risk foreign bank knew or should have known were associated with drug trafficking, financial fraud or other wrongdoing;
- conducting high yield investment scams by convincing investors to wire transfer funds to the correspondent account to earn high returns and then refusing to return any monies to the defrauded investors;
- conducting advance-fee-for-loan scams by requiring loan applicants to wire transfer large fees to the correspondent account, retaining the fees, and then failing to issue the loans;
- facilitating tax evasion by accepting client deposits, commingling them with other funds in the foreign bank's correspondent account, and encouraging clients to rely on bank and corporate secrecy laws in the foreign bank's home jurisdiction to shield the funds from U.S. tax authorities; and
- facilitating Internet gambling, illegal under U.S. law, by using the correspondent account to accept and transfer gambling proceeds.

While some U.S. banks have moved to conduct a systematic review of their correspondent banking practices and terminate questionable correspondent relationships, this effort is usually relatively recent and is not industry-wide.

Allowing high risk foreign banks and their criminal clients access to U.S. correspondent bank accounts facilitates crime, undermines the U.S. financial system, burdens U.S. taxpayers and consumers, and fills U.S. court dockets with criminal prosecutions and civil litigation by wronged parties. It is time for U.S. banks to shut the door to high risk foreign banks and eliminate other abuses of the U.S. correspondent banking system.

NOTE: COLOR CHART IN PRINTED VERSION OF REPORT

NOT AVAILABLE ON THE WEBSITE VERSION

**HIGH RISK FOREIGN BANKS
EXAMINED BY PSI MINORITY STAFF INVESTIGATION**

NAME OF BANK	CURRENT STATUS	LICENSE AND OPERATION	U.S. CORRESPONDENTS EXAMINED
American International Bank (AIB) 1992-1998	In Receivership	Licensed in Antigua/Barbuda Offshore Physical presence in Antigua	BAC of Florida Bank of America Barnett Bank Chase Manhattan Bank Toronto Dominion Union Bank of Jamaica
British Bank of Latin America (BBLA) 1981-2000	Closed	Licensed by Bahamas Offshore Physical presence in Bahamas and Columbia Wholly owned subsidiary of Lloyds TSB Bank	Bank of New York
British Trade and Commerce Bank (BTCB) 1997-present	Open	Licensed by Dominica Offshore Physical presence in Dominica	Banco Industrial de Venezuela (Miami) First Union National Bank Security Bank N.A.
Caribbean American Bank (CAB) 1994-1997	In Liquidation	Licensed by Antigua/Barbuda Offshore No physical presence	U.S. correspondents of AIB
European Bank 1972-present	Open	Licensed by Vanuatu Onshore Physical presence in Vanuatu	ANZ Bank (New York) Citibank
Federal Bank 1992-present	Open	Licensed by Bahamas Offshore No physical presence	Citibank
Guardian Bank and Trust (Cayman) Ltd. 1984-1995	Closed	Licensed by Cayman Islands Offshore Physical presence in Cayman Islands	Bank of New York
NAME OF BANK	CURRENT STATUS	LICENSE AND OPERATION	U.S. CORRESPONDENTS EXAMINED
Hanover Bank 1992-present	Open	Licensed by Antigua/Barbuda Offshore No physical presence	Standard Bank (Jersey) Ltd.'s U.S. correspondent, Harris Bank International (New York)
M.A. Bank 1991-present	Open	Licensed by Cayman Islands Offshore No physical presence	Citibank Union Bank of Switzerland (New York)
Overseas Development Bank and Trust (ODBT) 1996-present	Open	Licensed by Dominica Offshore Physical presence in Dominica (formerly in Antigua)	U.S. correspondents of AIB AmTrade International (Florida) Bank One

Swiss American Bank (SAB) 1983-present	Open	Licensed by Antigua/Barbuda Offshore Physical presence in Antigua	Bank of America Chase Manhattan Bank
Swiss American National Bank (SANB) 1981-present	Open	Licensed by Antigua/Barbuda Onshore Physical presence in Antigua	Bank of New York Chase Manhattan Bank

Prepared by Minority Staff of the U.S. Senate Permanent Subcommittee on Investigations, January 2001.

II. Minority Staff Investigation Into Correspondent Banking

To examine the vulnerability of correspondent banking to money laundering, the Minority Staff investigation interviewed experts; reviewed relevant banking laws, regulations and examination manuals; surveyed U.S. banks about their correspondent banking practices; reviewed court proceedings and media reports on cases of money laundering and correspondent banking; and developed ten detailed case histories of money laundering misconduct involving U.S. correspondent accounts. The one-year investigation included hundreds of interviews and the collection and review of over 25 boxes of documentation, including subpoenaed materials from 19 U.S. banks.

The Minority Staff began its investigation by interviewing a variety of anti-money laundering and correspondent banking experts. Included were officials from the U.S. Federal Reserve, U.S. Department of Treasury, Internal Revenue Service, Office of the Comptroller of the Currency, Financial Crimes Enforcement Network (“FinCEN”), U.S. Secret Service, U.S. State Department, and U.S. Department of Justice. Minority Staff investigators also met with bankers from the American Bankers Association, Florida International Bankers Association, and banking groups in the Bahamas and Cayman Islands, and interviewed at length a number of U.S. bankers experienced in monitoring correspondent accounts for suspicious activity. Extensive assistance was also sought from and provided by government and law enforcement officials in Antigua and Barbuda, Argentina, Australia, Bahamas, Cayman Islands, Dominica, Jersey, Ireland, the United Kingdom and Vanuatu.

Due to a paucity of information about correspondent banking practices in the United States, the Minority Staff conducted a survey of 20 banks with active correspondent banking portfolios. The 18-question survey sought information about the U.S. banks’ correspondent banking clients, procedures, and anti-money laundering safeguards. The survey results are described in Chapter IV.

To develop specific information on how correspondent banking is used in the United States to launder illicit funds, Minority Staff investigators identified U.S. criminal and civil money laundering indictments and pleadings which included references to U.S. correspondent accounts. Using these public court pleadings as a starting point, the Minority Staff identified the foreign banks and U.S. banks involved in the facts of the case, and the circumstances associated with how the foreign banks’ U.S. correspondent accounts became conduits for laundered funds. The investigation obtained relevant court proceedings, exhibits and related documents, subpoenaed U.S. bank documents, interviewed U.S. correspondent bankers and, when possible, interviewed foreign bank officials and government personnel. From this material, the investigation examined how foreign banks opened and used their U.S. correspondent accounts and how the U.S. banks monitored or failed to monitor the foreign banks and their account activity.

The investigation included an interview of a U.S. citizen who formerly owned a bank in the Cayman Islands, has pleaded guilty to money laundering, and was willing to explain the mechanics of how his bank laundered millions of dollars for U.S. citizens through U.S. correspondent accounts. Another interview was with a U.S. citizen who has pleaded guilty to conspiracy to

commit money laundering and was willing to explain how he used three offshore banks to launder illicit funds from a financial investment scheme that defrauded hundreds of U.S. citizens. Other interviews were with foreign bank owners who explained how their bank operated, how they used correspondent accounts to transact business, and how their bank became a conduit for laundered funds. Numerous interviews were conducted with U.S. bank officials.

Because the investigation began with criminal money laundering indictments in the United States, attention was directed to foreign banks and jurisdictions known to U.S. criminals. The case histories featured in this report are not meant to be interpreted as identifying the most problematic banks or jurisdictions. To the contrary, a number of the jurisdictions identified in this report have taken significant strides in strengthening their banking and anti-money laundering controls. The evidence indicates that equivalent correspondent banking abuses may be found throughout the international banking community,⁶ and that measures need to be taken in major financial centers throughout the world to address the types of money laundering risks identified in this report.

III. Anti-Money Laundering Obligations

Two laws lay out the basic anti-money laundering obligations of all United States banks. First is the Bank Secrecy Act which, in section 5318(h) of Title 31 in the U.S. Code, requires all U.S. banks to have anti-money laundering programs. It states:

In order to guard against money laundering through financial institutions, the Secretary [of the Treasury] may require financial institutions to carry out anti-money laundering programs, including at a minimum -- (A) the development of internal policies, procedures, and controls, (B) the designation of a compliance officer, (C) an ongoing employee training program, and (D) an independent audit function to test programs.

The Bank Secrecy Act also authorizes the U.S. Department of the Treasury to require financial institutions to file reports on currency transactions and suspicious activities, again as part of U.S. efforts to combat money laundering. The Treasury Department has accordingly issued regulations and guidance requiring U.S. banks to establish anti-money laundering programs and file certain currency transaction reports (“CTRs”) and suspicious activity reports (“SARs”).⁷

⁶See, for example, “German Officials Investigate Possible Money Laundering,” Wall Street Journal (1/16/01)(Germany); “Prosecutors set to focus on Estrada bank records,” BusinessWorld (1/15/01)(Philippines); “Canada’s Exchange Bank & Trust Offers Look at ‘Brass-Plate’ Banks,” Wall Street Journal (12/29/00)(Canada, Nauru, St. Kitts-Nevis); “Peru’s Montesinos hires lawyer in Switzerland to keep bank accounts secret,” Agence France Presse (12/11/00)(Peru, Switzerland); “The Billion Dollar Shack,” New York Times Magazine (12/10/00) (Nauru, Russia); “Launderers put UK banks in a spin,” Financial Times (London)(United Kingdom, Luxembourg, Switzerland, Nigeria); “Croats Find Treasury Plundered,” Washington Post (6/13/00)(Croatia); “Arrests and millions missing in troubled offshore bank,” Associated Press (9/11/00)(Grenada); “Judgement Daze,” Sunday Times (London) (10/18/98)(Ireland); “That’s Laird To You, Mister,” New York Times (2/27/00)(multiple countries).

⁷See, for example, 31 C.F.R. §§103.11 and 103.21 et seq. CTRs identify cash transactions above a specified threshold; SARs identify possibly illegal transactions observed by bank personnel.

The second key law is the Money Laundering Control Act of 1986, which was enacted partly in response to hearings held by the Permanent Subcommittee on Investigations in 1985. This law was the first in the world to make money laundering an independent crime. It prohibits any person from knowingly engaging in a financial transaction which involves the proceeds of a "specified unlawful activity." The law provides a list of specified unlawful activities, including drug trafficking, fraud, theft and bribery.

The aim of these two statutes is to enlist U.S. banks in the fight against money laundering. Together they require banks to refuse to engage in financial transactions involving criminal proceeds, to monitor transactions and report suspicious activity, and to operate active anti-money laundering programs. Both statutes have been upheld by the Supreme Court.

Recently, U.S. bank regulators have provided additional guidance to U.S. banks about the anti-money laundering risks in correspondent banking and the elements of an effective anti-money laundering program. In the September 2000 "Bank Secrecy Act/Anti-Money Laundering Handbook," the Office of the Comptroller of the Currency (OCC) deemed international correspondent banking a "high-risk area" for money laundering that warrants "heightened scrutiny." The OCC Handbook provides the following anti-money laundering considerations that a U.S. bank should take into account in the correspondent banking field:

A bank must exercise caution and due diligence in determining the level of risk associated with each of its correspondent accounts. Information should be gathered to understand fully the nature of the correspondent's business. Factors to consider include the purpose of the account, whether the correspondent bank is located in a bank secrecy or money laundering haven (if so, the nature of the bank license, i.e., shell/offshore bank, fully licensed bank, or an affiliate/subsidiary of a major financial institution), the level of the correspondent's money laundering prevention and detection efforts, and the condition of bank regulation and supervision in the correspondent's country.⁸

The OCC Handbook singles out three activities in correspondent accounts that warrant heightened anti-money laundering scrutiny and analysis:

Three of the more common types of activity found in international correspondent bank accounts that should receive heightened scrutiny are funds (wire) transfer[s], correspondent accounts used as 'payable through accounts' and 'pouch/cash letter activity.' This heightened risk underscores the need for effective and comprehensive systems and controls particular to these types of accounts.⁹

With respect to wire transfers, the OCC Handbook provides the following additional guidance:

Although money launderers use wire systems in many ways, most money launderers

⁸"Bank Secrecy Act/Anti-Money Laundering Handbook" (September 2000), at 22.

⁹Id.

aggregate funds from different sources and move them through accounts at different banks until their origin cannot be traced. Most often they are moved out of the country through a bank account in a country where laws are designed to facilitate secrecy, and possibly back into the United States. ... Unlike cash transactions that are monitored closely, ... [wire transfer systems and] a bank's wire room are designed to process approved transactions quickly. Wire room personnel usually have no knowledge of the customer or the purpose of the transaction. Therefore, other bank personnel must know the identity and business of the customer on whose behalf they approve the funds transfer to prevent money launderers from using the wire system with little or no scrutiny. Also, review or monitoring procedures should be in place to identify unusual funds transfer activity.¹⁰

IV. Correspondent Banking Industry in the United States

Correspondent banking is the provision of banking services by one bank to another bank. It is a lucrative and important segment of the banking industry. It enables banks to conduct business and provide services for their customers in jurisdictions where the banks have no physical presence. For example, a bank that is licensed in a foreign country and has no office in the United States may want to provide certain services in the United States for its customers in order to attract or retain the business of important clients with U.S. business activities. Instead of bearing the costs of licensing, staffing and operating its own offices in the United States, the bank might open a correspondent account with an existing U.S. bank. By establishing such a relationship, the foreign bank, called a respondent, and through it, its customers, can receive many or all of the services offered by the U.S. bank, called the correspondent.¹¹

Today, banks establish multiple correspondent relationships throughout the world so they may engage in international financial transactions for themselves and their clients in places where they do not have a physical presence. Many of the largest international banks located in the major financial centers of the world serve as correspondents for thousands of other banks. Due to U.S. prominence in international trade and the high demand for U.S. dollars due to their overall stability, most foreign banks that wish to provide international services to their customers have accounts in the United States capable of transacting business in U.S. dollars. Those that lack a physical presence in the U.S. will do so through correspondent accounts, creating a large market for those services.¹²

¹⁰Id. at 23.

¹¹Similar correspondent banking relationships are also often established between domestic banks, such as when a local domestic bank opens an account at a larger domestic bank located in the country's financial center.

¹²International correspondent banking is a major banking activity in the United States in part due to the popularity of the U.S. dollar. U.S. dollars are one of a handful of major currencies accepted throughout the world. They are also viewed as a stable currency, less likely to lose value over time and, thus, a preferred vehicle for savings, trade and investment. Since U.S. dollars are also the preferred currency of U.S. residents, foreign companies and individuals seeking to do business in the United States may feel compelled to use U.S. dollars.

Large correspondent banks in the U.S. manage thousands of correspondent relationships with banks in the United States and around the world. Banks that specialize in international funds transfers and process large numbers and dollar volumes of wire transfers daily are sometimes referred to as money center banks. Some money center banks process as much as \$1 trillion in wire transfers each day. As of mid-1999, the top five correspondent bank holding companies in the United States held correspondent account balances exceeding \$17 billion; the total correspondent account balances of the 75 largest U.S. correspondent banks was \$34.9 billion.¹³

A. Correspondent Banking Products and Services

Correspondent banks often provide their respondent banks with an array of cash management services, such as interest-bearing or demand deposit accounts in one or more currencies, international wire transfers of funds, check clearing, payable through accounts,¹⁴ and foreign exchange services. Correspondent banks also often provide an array of investment services, such as providing their respondent banks with access to money market accounts, overnight investment accounts, certificates of deposit, securities trading accounts, or other accounts bearing higher rates of interest than are paid to non-bank clients. Along with these services, some correspondent banks offer computer software programs that enable their respondent banks to complete various transactions, initiate wire transfers, and gain instant updates on their account balances through their own computer terminals.

With smaller, less well-known banks, a correspondent bank may limit its relationship with the respondent bank to non-credit, cash management services. With respondent banks that are judged to be secure credit risks, the correspondent bank may also afford access to a number of credit-related products. These services include loans, daylight or overnight extensions of credit for account transactions, lines of credit, letters of credit, merchant accounts to process credit card transactions, international escrow accounts, and other trade and finance-related services.

An important feature of most correspondent relationships is providing access to

In the money laundering world, U.S. dollars are popular for many of the same reasons. In addition, U.S. residents targeted by financial frauds often deal only in U.S. dollars, and any perpetrator of a fraud planning to take their money must be able to process U.S. dollar checks and wire transfers. The investigation found that foreign offshore banks often believe wire transfers between U.S. banks receive less money laundering scrutiny than wire transfers involving an offshore jurisdiction and, in order to take advantage of the lesser scrutiny afforded U.S. bank interactions, prefer to keep their funds in a U.S. correspondent account and transact business through their U.S. bank. In fact, all of the foreign banks examined in the Minority Staff investigation characterized U.S. dollars as their preferred currency, all sought to open U.S. dollar accounts, and all used their U.S. dollar accounts much more often than their other currency accounts.

¹³“Top 75 Correspondent Bank Holding Companies,” The American Banker (12/8/99) at 14.

¹⁴“Payable through accounts” allow a respondent bank’s clients to write checks that draw directly on the respondent bank’s correspondent account. See Advisory Letter 95-3, issued by the Office of the Comptroller of the Currency identifying them as high risk accounts for money laundering. Relatively few banks offer these accounts at the present time.

international funds transfer systems.¹⁵ These systems facilitate the rapid transfer of funds across international lines and within countries. These transfers are accomplished through a series of electronic communications that trigger a series of debit/credit transactions in the ledgers of the financial institutions that link the originators and beneficiaries of the payments. Unless the parties to a funds transfer use the same financial institution, multiple banks will be involved in the payment transfer. Correspondent relationships between banks provide the electronic pathway for funds moving from one jurisdiction to another.

For the types of foreign banks investigated by the Minority Staff, in particular shell banks with no office or staff and offshore banks transacting business with non-residents in non-local currencies, correspondent banking services are critical to their existence and operations. These banks keep virtually all funds in their correspondent accounts. They conduct virtually all transactions external to the bank – including deposits, withdrawals, check clearings, certificates of deposit, and wire transfers – through their correspondent accounts. Some use software provided by their correspondents to operate their ledgers, track account balances, and complete wire transfers. Others use their monthly correspondent account statements to identify client deposits and withdrawals, and assess client fees. Others rely on their correspondents for credit lines and overnight investment accounts. Some foreign banks use their correspondents to provide sophisticated investment services to their clients, such as high-interest bearing money market accounts and securities trading. While the foreign banks examined in the investigation lacked the resources, expertise and infrastructure needed to provide such services in-house, they could all afford the fees charged by their correspondents to provide these services and used the services to attract clients and earn revenue.

Every foreign bank interviewed by the investigation indicated that it was completely dependent upon correspondent banking for its access to international wire transfer systems and the infrastructure required to complete most banking transactions today, including handling multiple currencies, clearing checks, paying interest on client deposits, issuing credit cards, making investments, and moving funds. Given their limited resources and staff, all of the foreign banks interviewed by the investigation indicated that, if their access to correspondent banks were cut off, they would be unable to function. Correspondent banking is their lifeblood.

B. Three Categories of High Risk Banks

Three categories of banks present particularly high money laundering risks for U.S. correspondent banks: (1) shell banks that have no physical presence in any jurisdiction; (2) offshore banks that are barred from transacting business with the citizens of their own licensing jurisdictions; and (3) banks licensed by jurisdictions that do not cooperate with international anti-money laundering efforts.

Shell Banks. Shell banks are high risk banks principally because they are so difficult to

¹⁵These funds transfer systems include the Society for Worldwide Interbank Financial Telecommunications (“SWIFT”), the Clearing House Interbank Payments System (“CHIPS”), and the United States Federal Wire System (“Fedwire”).

monitor and operate with great secrecy. As used in this report, the term “shell bank” is intended to have a narrow reach and refer only to banks that have no physical presence in any jurisdiction. The term is not intended to encompass a bank that is a branch or subsidiary of another bank with a physical presence in another jurisdiction. For example, in the Cayman Islands, of the approximately 570 licensed banks, most do not maintain a Cayman office, but are affiliated with banks that maintain offices in other locations. As used in this report, “shell bank” is not intended to apply to these affiliated banks – for example, the Cayman branch of a large bank in the United States. About 75 of the 570 Cayman-licensed banks are not branches or subsidiaries of other banks, and an even smaller number operate without a physical presence anywhere. It is these shell banks that are of concern in this report. In the Bahamas, out of a total of about 400 licensed banks, about 65 are unaffiliated with any other bank, and a smaller subset are shell banks. Some jurisdictions, including the Cayman Islands, Bahamas and Jersey, told the Minority Staff investigation that they no longer issue bank licenses to unaffiliated shell banks, but other jurisdictions, including Nauru, Vanuatu and Montenegro, continue to do so. The total number of shell banks operating in the world today is unknown, but banking experts believe it comprises a very small percentage of all licensed banks.

The Minority Staff investigation was able to examine several shell banks in detail. Hanover Bank, for example, is an Antiguan licensed bank that has operated primarily out of its owner’s home in Ireland. M.A. Bank is a Cayman licensed bank which claims to have an administrative office in Uruguay, but actually operated in Argentina using the offices of related companies. Federal Bank is a Bahamian licensed bank which serviced Argentinian clients but appears to have operated from an office or residence in Uruguay. Caribbean American Bank, now closed, was an Antiguan-licensed bank that operated out of the offices of an Antiguan firm that supplied administrative services to banks.

None of these four shell banks had an official business office where it conducted banking activities; none had a regular paid staff. The absence of a physical office with regular employees helped these shell banks avoid oversight by making it more difficult for bank regulators and others to monitor bank activities, inspect records and question bank personnel. Irish banking authorities, for example, were unaware that Hanover Bank had any connection with Ireland, and Antiguan banking regulators did not visit Ireland to examine the bank on-site. Argentine authorities were unaware of M.A. Bank’s presence in their country and so never conducted any review of its activities. Cayman bank regulators did not travel to Argentina or Uruguay for an on-site examination of M.A. Bank; and regulators from the Bahamas did not travel to Argentina or Uruguay to examine Federal Bank.

The Minority Staff was able to gather information about these shell banks by conducting interviews, obtaining court pleadings and reviewing subpoenaed material from U.S. correspondent banks. The evidence shows that these banks had poor to nonexistent administrative and anti-money laundering controls, yet handled millions of dollars in suspect funds, and compiled a record of dubious activities associated with drug trafficking, financial fraud and other misconduct.

Offshore Banks. The second category of high risk banks in correspondent banking are offshore banks. Offshore banks have licenses which bar them from transacting banking activities

with the citizens of their own licensing jurisdiction or bar them from transacting business using the local currency of the licensing jurisdiction. Nearly all of the foreign banks investigated by the Minority Staff held offshore licenses.

The latest estimates are that nearly 60 offshore jurisdictions around the globe¹⁶ have, by the end of 1998, licensed about 4,000 offshore banks.¹⁷ About 44% of these offshore banks are thought to be located in the Caribbean and Latin America, 29% in Europe, 19% in Asia and the Pacific, and 10% in Africa and the Middle East.¹⁸ These banks are estimated to control nearly \$5 trillion in assets.¹⁹ Since, by design, offshore banks operate in the international arena, outside their licensing jurisdiction, they have attracted the attention of the international financial community. Over the past few years, as the number, assets and activities of offshore banks have expanded, the international financial community has expressed increasing concerns about their detrimental impact on international anti-money laundering efforts.²⁰

Offshore banks pose high money laundering risks in the correspondent banking field for a variety of reasons. One is that a foreign country has significantly less incentive to oversee and regulate banks that do not do business within the country's boundaries than for banks that do.²¹ Another is that offshore banking is largely a money-making enterprise for the governments of small countries, and the less demands made by the government on bank owners, the more attractive the country becomes as a licensing locale. Offshore banks often rely on these reverse incentives to minimize oversight of their operations, and become vehicles for money laundering, tax evasion, and suspect funds.

One U.S. correspondent banker told the Minority Staff that he is learning that a large percentage of clients of offshore banks are Americans and, if so, there is a "good chance tax evasion is going on." He said there is "no reason" for offshore banking to exist if not for "evasion, crime, or whatever." There is no reason for Americans to bank offshore, he said, noting that if an offshore bank has primarily U.S. clients, it must "be up to no good" which raises a question why a U.S. bank would take on the offshore bank as a client. A former offshore bank owner told the investigation that he thought 100% of his clients had been engaged in tax evasion which was why they sought bank secrecy and were willing to pay costly offshore fees that no U.S. bank would

¹⁶See INCSR 2000 at 565. Offshore jurisdictions are countries which have enacted laws allowing the formation of offshore banks or other offshore entities.

¹⁷INCSR 2000 at 566 and footnote 3, citing "The UN Offshore Forum," Working Paper of the United Nations Office for Drug Control and Crime Prevention (January 2000) at 6.

¹⁸Id.

¹⁹INCSR 2000 at 566 and footnote 1, citing "Offshore Banking: An Analysis of Micro- and Macro-Prudential Issues," Working Paper of the International Monetary Fund (1999), by Luca Errico and Alberto Musalem, at 10.

²⁰See, for example, INCSR 2000 discussion of "Offshore Financial Centers," at 565-77.

²¹See also discussion in Chapter V, subsections (D), (E) and (F).

charge.

Another longtime U.S. correspondent banker was asked his opinion of a former offshore banker's comment that to "take-in" deposits from U.S. nationals was not a transgression and that not reporting offshore investments "is no legal concern of the offshore depository institution." The correspondent banker said that the comment showed that the offshore banker "knew his craft." He said that the whole essence of offshore banking is "accounts in the name of corporations with bearer shares, directors that are lawyers that sit in their tax havens that make up minutes of board meetings." When asked if part of the correspondent banker's job was to make sure the client bank did not "go over the line," the correspondent banker responded if that was the case, then the bank should not be dealing with some of the bank clients it had and should not be doing business in some of the countries where it was doing business.

Because offshore banks use non-local currencies and transact business primarily with non-resident clients, they are particularly dependent upon having correspondent accounts in other countries to transact business. One former offshore banker commented in an interview that if the American government wanted to get offshore banks "off their back," it would prohibit U.S. banks from having correspondent relationships with offshore banks. This banker noted that without correspondent relationships, the offshore banks "would die." He said "they need an established bank that can offer U.S. dollars."

How offshore banks use correspondent accounts to launder funds is discussed in Chapter VI of this report as well as in a number of the case histories. The offshore banks investigated by the Minority Staff were, like the shell banks, associated with millions of dollars in suspect funds, drug trafficking, financial fraud and other misconduct.

Banks in Non-Cooperating Jurisdictions. The third category of high risk banks in correspondent banking are foreign banks licensed by jurisdictions that do not cooperate with international anti-money laundering efforts. International anti-money laundering efforts have been led by the Financial Action Task Force on Money Laundering ("FATF"), an inter-governmental organization comprised of representatives from the financial, regulatory and law enforcement communities from over two dozen countries. In 1996, FATF developed a set of 40 recommendations that now serve as international benchmarks for evaluating a country's anti-money laundering efforts. FATF has also encouraged the establishment of international organizations whose members engage in self and mutual evaluations to promote regional compliance with the 40 recommendations.

In June 2000, for the first time, FATF formally identified 15 countries and territories whose anti-money laundering laws and procedures have "serious systemic problems" resulting in their being found "non-cooperative" with international anti-money laundering efforts. The 15 are: the Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis, and St. Vincent and the

Grenadines.²² Additional countries are expected to be identified in later evaluations.

FATF had previously established 25 criteria to assist it in the identification of non-cooperative countries or territories.²³ The published criteria included, for example, “inadequate regulation and supervision of financial institutions”; “inadequate rules for the licensing and creation of financial institutions, including assessing the backgrounds of their managers and beneficial owners”; “inadequate customer identification requirements for financial institutions”; “excessive secrecy provisions regarding financial institutions”; “obstacles to international co-operation” by administrative and judicial authorities; and “failure to criminalize laundering of the proceeds from serious crimes.” FATF explained that, “detrimental rules and practices which obstruct international co-operation against money laundering ... naturally affect domestic prevention or detection of money laundering, government supervision and the success of investigations into money laundering.” FATF recommended that, until the named jurisdictions remedied identified deficiencies, financial institutions around the world should exercise heightened scrutiny of transactions involving those jurisdictions and, if improvements were not made, that FATF members “consider the adoption of counter-measures.”²⁴

Jurisdictions with weak anti-money laundering laws and weak cooperation with international anti-money laundering efforts are more likely to attract persons interested in laundering illicit proceeds. The 15 named jurisdictions have together licensed hundreds and perhaps thousands of banks, all of which introduce money laundering risks into international correspondent banking.

C. Survey on Correspondent Banking

In February 2000, Senator Levin, Ranking Minority Member of the Permanent Subcommittee on Investigations, distributed a survey on correspondent banking to 20 banks providing correspondent services from locations in the United States. Ten of the banks were domiciled in the United States; ten were foreign banks doing business in the United States. Their correspondent banking portfolios varied in size, and in the nature of customers and services involved. The survey of 18 questions was sent to:

ABN AMRO Bank of Chicago, Illinois
Bank of America, Charlotte, North Carolina
The Bank of New York, New York, New York
Bank of Tokyo Mitsubishi Ltd., New York, New York
Bank One Corporation, Chicago, Illinois
Barclays Bank PLC - Miami Agency, Miami, Florida
Chase Manhattan Bank, New York, New York

²²See FATF’s “Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures” (6/22/00), at paragraph (64).

²³See FATF’s 1999-2000 Annual Report, Annex A.

²⁴FATF 6/22/00 review at paragraph (67).

Citigroup, Inc., New York, New York
Deutsche Bank A.G./Bankers Trust, New York, New York
Dresdner Bank, New York, New York
First Union Bank, Charlotte, North Carolina
FleetBoston Bank, Boston, Massachusetts
HSBC Bank, New York, New York
Israel Discount Bank, New York, New York
MTB Bank, New York, New York
Riggs Bank, Washington, D.C.
Royal Bank of Canada, Montreal, Quebec, Canada
The Bank of Nova Scotia (also called ScotiaBank), New York, New York
Union Bank of Switzerland AG, New York, New York
Wells Fargo Bank, San Francisco, California

All 20 banks responded to the survey, and the Minority Staff compiled and reviewed the responses. One Canadian bank did not respond to the questions directed at its correspondent banking practices, because it said it did not conduct any correspondent banking activities in the United States.

The larger banks in the survey each have, worldwide, over a half trillion dollars in assets, at least 90,000 employees, a physical presence in over 35 countries, and thousands of branches. The smallest bank in the survey operates only in the United States, has less than \$300 million in assets, 132 employees and 2 branches. Three fourths of the banks surveyed have over one-thousand correspondent banking relationships and many have even more correspondent banking accounts. Two foreign banks doing business in the United States had the most correspondent accounts worldwide (12,000 and 7,500, respectively). The U.S. domiciled bank with the most correspondent accounts reported over 3,800 correspondent accounts worldwide.

The survey showed an enormous movement of money through wire transfers by the biggest banks. The largest number of wire transfers processed worldwide by a U.S. domiciled bank averaged almost a million wire transfers processed daily. The largest amount of money processed by a U.S. domiciled bank is over \$1 trillion daily. Eleven of the banks surveyed move over \$50 billion each in wire transfers in the United States each day; 7 move over \$100 billion each day. The smallest bank surveyed moves daily wire transfers in the United States totaling \$114 million.

The banks varied widely on the number of correspondent banking relationship managers employed in comparison to the number of correspondent banking relationships maintained.²⁵ One U.S. domiciled bank, for example, reported it had 31 managers worldwide for 2,975 relationships, or a ratio of 96 to 1. Another bank reported it had 40 relationship managers worldwide handling 1,070 correspondent relationships, or a ratio of 27 to 1. One bank had a ratio of less than 7 to 1, but that was clearly the exception. The average ratio is approximately 40 or 50 correspondent relationships to each relationship manager for U.S. domiciled banks and approximately 95 to 1 for

²⁵“Relationship manager” is a common term used to describe the correspondent bank employees responsible for initiating and overseeing the bank’s correspondent relationships.

foreign banks.

In response to a survey question asking about the growth of their correspondent banking business since 1995, 3 banks reported substantial growth, 6 banks reported moderate growth, 2 banks reported a substantial decrease in correspondent banking, 1 bank reported a moderate decrease, and 7 banks reported that their correspondent banking business had remained about the same. Several banks reporting changes indicated the change was due to a merger, acquisition or sale of a bank or correspondent banking unit.

The banks varied somewhat on the types of services offered to correspondent banking customers, but almost every bank offered deposit accounts, wire transfers, check clearing, foreign exchange, trade-related services, investment services, and settlement services. Only 6 banks offered the controversial “payable through accounts” that allow a respondent bank’s clients to write checks that draw directly on the respondent bank’s correspondent account.

While all banks reported having anti-money laundering and due diligence policies and written guidelines, most of the banks do not have such policies or guidelines specifically tailored to correspondent banking; they rely instead on general provisions in the bank-wide policy for correspondent banking guidance and procedures. One notable exception is the “Know Your Customer Policy Statement” adopted by the former Republic National Bank of New York, now HSBC USA, for its International Banking Group, that specifically addressed new correspondent banking relationships. Effective December 31, 1998, the former Republic National Bank established internal requirements for a thorough, written analysis of any bank applying for a correspondent relationship, including, among other elements, an evaluation of the applicant bank’s management and due diligence policies.

In response to survey questions about opening new correspondent banking relationships, few banks said that their due diligence procedures were mandatory; instead, the majority said they were discretionary depending upon the circumstances of the applicant bank. All banks indicated that they followed three specified procedures, but varied with respect to others. Survey results with respect to 12 specified account opening procedures were as follows:

All banks said they:

- Obtain financial statements;
- Evaluate credit worthiness; and
- Determine an applicant’s primary lines of business.

All but 2 banks said they:

- Verify an applicant’s bank license; and
- Determine whether an applicant has a fixed, operating office in the licensing jurisdiction.

All but 3 banks said they:

- Evaluate the overall adequacy of banking supervision in the jurisdiction of the respondent bank; and

- Review media reports for information on an applicant.

All but 4 banks said they visit an applicant's primary office in the licensing jurisdiction; all but 5 banks said they determine if the bank's license restricts the applicant to operating outside the licensing jurisdiction, making it an offshore bank. A majority of the surveyed banks said they inquire about the applicant with the jurisdiction's bank regulators. Only 6 banks said they inquire about an applicant with U.S. bank regulators.

A majority of banks listed several other actions they take to assess a correspondent bank applicant, including:

- Checking with the local branch bank, if there is one;
- Checking with bank rating agencies;
- Obtaining bank references; and
- Completing a customer profile.

The survey asked the banks whether or not, as a policy matter, they would establish a correspondent bank account with a bank that does not have a physical presence in any location or whose only license requires it to operate outside the licensing jurisdiction, meaning it holds only an offshore banking license. Only 18 of the 20 banks responded to these questions. Twelve banks said they would not open a correspondent account with a bank that does not have a physical presence; 9 banks said they would not open a correspondent account with an offshore bank. Six banks said there are times, depending upon certain circumstances, under which they would open an account with a bank that does not have a physical presence in any country; 8 banks said there are times when they would open an account with an offshore bank. The circumstances include a bank that is part of a known financial group or a subsidiary or affiliate of a well-known, internationally reputable bank. Only one of the surveyed banks said it would, without qualification, open a correspondent account for an offshore bank.

Surveyed banks were asked to identify the number of correspondent accounts they have had in certain specified countries,²⁶ in 1995 and currently. As expected, several banks have had a large number of correspondent accounts with banks in China. For example, one bank reported 218 relationships, another reported 103 relationships, and four others reported 45, 43, 39 and 27 relationships, respectively. Seven banks reported more than 30 relationships with banks in Switzerland, with the largest numbering 95 relationships. Five banks reported having between 14 and 49 relationships each with banks in Colombia.

The U.S. State Department's March 2000 International Narcotics Control Strategy Report and the Financial Action Task Force's June 2000 list of 15 jurisdictions with inadequate anti-money laundering efforts have raised serious concerns about banking practices in a number of

²⁶The survey asked about correspondent relationships with banks in Antigua, Austria, Bahamas, Burma, Cayman Islands, Channel Islands, China, Colombia, Cyprus, Indonesia, Latvia, Lebanon, Lichtenstein, Luxembourg, Malta, Nauru, Nigeria, Palau, Panama, Paraguay, Seychelle Islands, Singapore, Switzerland, Thailand, United Arab Emirates, Uruguay, Vanuatu, and other Caribbean and South Pacific island nations.

countries, and the survey showed that in some of those countries, U.S. banks have longstanding or numerous correspondent relationships. For example, five banks reported having between 40 and 84 relationships each with banks in Russia, down from seven banks reporting relationships that numbered between 52 and 282 each in 1995.²⁷ Five banks reported having between 13 and 44 relationships each with banks in Panama. One bank has a correspondent relationship with a bank in Nauru, and two banks have one correspondent relationship each with a bank in Vanuatu. Three banks have correspondent accounts with one or two banks in the Seychelle Islands and one or two banks in Burma.

There are several countries where only one or two of the surveyed banks has a particularly large number of correspondent relationships. These are Antigua, where most banks have no relationships but one bank has 12; the Channel Islands, where most banks have no relationships but two banks have 29 and 27 relationships, respectively; Nigeria, where most banks have few to no relationships but two banks have 34 and 31 relationships, respectively; and Uruguay, where one bank has 28 correspondent relationships and the majority of other banks have ten or less. One bank reported having 67 correspondent relationships with banks in the Bahamas; only two other banks have more than 10 correspondent relationships there. That same bank has 146 correspondent relationships in the Cayman Islands; only two banks have more than 12 such relationships, and the majority of banks have two or less.

The survey asked the banks to explain how they monitor their correspondent accounts. The responses varied widely. Some banks use the same monitoring systems that they use with all other accounts -- relying on their compliance departments and computer software for reviews. Others place responsibility for monitoring the correspondent banking accounts in the relationship manager, requiring the manager to know what his or her correspondent client is doing on a regular basis. Nine banks reported that they placed the monitoring responsibility with the relationship manager, requiring that the manager perform monthly monitoring of the accounts under his or her responsibility. Others reported relying on a separate compliance office in the bank or an anti-money laundering unit to identify suspicious activity. Monitoring can also be done with other tools. For example, one bank said it added news articles mentioning companies and banks into an information database available to bank employees.

Several banks reported special restrictions they have imposed on correspondent banking relationships in addition to the procedures identified in the survey. One bank reported, for example, that it prohibits correspondent accounts in certain South Pacific locations and monitors all transactions involving Antigua and Barbuda, Belize and Seychelles. Another bank said it requires its relationship managers to certify that a respondent bank does not initiate transfers to high risk geographic areas, and if a bank is located in a high risk geographic area, it requires a separate certification. One bank said its policy is to have a correspondent relationship with a bank in a foreign country only if the U.S. bank has a physical presence in the country as well. Similarly, another bank said it does not accept transfers from or to Antigua, Nauru, Palau, the Seychelles, or Vanuatu. One bank reported that it takes relationship managers off-line, that is,

²⁷The survey found that the number of U.S. correspondent relationships with Russian banks dropped significantly after the Bank of New York scandal of 1999, as described in the appendix.

away from their responsibility for their correspondent banks, for ten days at a time to allow someone else to handle the correspondent accounts as a double-check on the activity. The Minority Staff did not attempt to examine how these stated policies are actually put into practice in the banks.

The surveyed banks were asked how many times between 1995 and 1999 they became aware of possible money laundering activities involving a correspondent bank client. Of the 17 banks that said they could answer the question, 7 said there were no instances in which they identified such suspicious activity. Ten banks identified at least one instance of suspicious activity. One bank identified 564 SARs filed due to “sequential strings of travelers checks and money orders.” The next largest number was 60 SARs which the surveyed bank said involved “correspondent banking and possible money laundering.” Another bank said it filed 52 SARs in the identified time period. Two banks identified only one instance; the remaining banks each referred to a handful of instances.

There were a number of anomalies in the survey results. For example, one large bank which indicated in an interview that it does not market correspondent accounts in secrecy havens, reported in the survey having 146 correspondent relationships with Cayman Island banks and 67 relationships with banks in the Bahamas, both of which have strict bank secrecy laws. Another bank said in a preliminary interview that it would “never” open a correspondent account with a bank in Vanuatu disclosed in the survey that it, in fact, had a longstanding correspondent relationship in Vanuatu. Another bank stated in its survey response it would not open an account with an offshore bank, yet also reported in the survey that its policy was not to ask bank applicants whether they were restricted to offshore licenses. Two other banks reported in the survey that they would not, as a policy matter, open correspondent accounts with offshore or shell banks, but when confronted with information showing they had correspondent relationships with these types of banks, both revised their survey responses to describe a different correspondent banking policy. These and other anomalies suggest that U.S. banks may not have accurate information or a complete understanding of their correspondent banking portfolios and practices in the field.

D. Internet Gambling

One issue that unexpectedly arose during the investigation was the practice of foreign banks using their U.S. correspondent accounts to handle funds related to Internet gambling. As a result, the U.S. correspondent banks facilitated Internet gambling, an activity recognized as a growing industry providing new avenues and opportunities for money laundering.

Two recent national studies address the subject: “The Report of the National Gambling Impact Study Commission,” and a report issued by the Financial Crimes Enforcement Network (“FinCEN”) entitled, “A Survey of Electronic Cash, Electronic Banking, and Internet Gaming.”²⁸

²⁸The National Gambling Impact Study Commission (“NGISC”) was created in 1996 to conduct a comprehensive legal and factual study of the social and economic impacts of gambling in the United States. The NGISC report, published in June 1999, contains a variety of information and recommendations related to Internet gambling. The FinCEN report, published in September 2000, examines money laundering issues related to Internet

Together, these reports describe the growth of Internet gambling and related legal issues. They report that Internet gambling websites include casino-type games such as virtual blackjack, poker and slot machines; sports event betting; lotteries; and even horse race wagers using real-time audio and video to broadcast live races. Websites also typically require players to fill out registration forms and either purchase “chips” or set up accounts with a minimum amount of funds. The conventional ways of sending money to the gambling website are: (1) providing a credit card number from which a cash advance is taken; (2) sending a check or money order; or (3) sending a wire transfer or other remittance of funds.

An important marketing tool for the Internet gambling industry is the ability to transfer money quickly, inexpensively and securely.²⁹ These money transfers together with the off-shore locations of most Internet gambling operations and their lack of regulation provide prime opportunities for money laundering.³⁰ As technology progresses, the speed and anonymity of the transactions may prove to be even more attractive to money launderers.

One researcher estimates that in 1997, there were as many as 6.9 million potential Internet gamblers and Internet gambling revenues of \$300 million. By 1998, these estimates had doubled, to an estimated 14.5 million potential Internet gamblers and Internet gambling revenues of \$651 million. The River City Group, an industry consultant, forecasts that U.S. Internet betting will rise from \$1.1 billion in 1999, to \$3 billion in 2002.

Current federal and state laws. In the United States, gambling regulation is primarily a matter of state law, reinforced by federal law where the presence of interstate or foreign elements might otherwise frustrate the enforcement policies of state law.³¹ According to a recent Congressional Research Service report, Internet gambling implicates at least six federal criminal statutes, which make it a federal crime to: (1) conduct an illegal gambling business, 18 U.S.C. §1955 (illegal gambling business); (2) use the telephone or telecommunications to conduct an illegal gambling business, 18 U.S.C. §1084 (Interstate Wire Act); (3) use the facilities of interstate commerce to conduct an illegal gambling business, 18 U.S.C. § 1952 (Travel Act); (4) conduct the

gambling.

²⁹More than a dozen companies develop and sell turnkey software for Internet gambling operations. Some of these companies provide full service packages, which include the processing of financial transactions and maintenance of offshore hardware, while the “owner” of the gambling website simply provides advertising and Internet access to gambling customers. These turnkey services make it very easy for website owners to open new gambling sites.

³⁰See, for example, the FinCEN report, which states at page 41: “Opposition in the United States to legalized Internet gaming is based on several factors. First, there is the fear that Internet gaming ... offer[s] unique opportunities for money laundering, fraud, and other crimes. Government officials have also expressed concerns about underage gaming and addictive gambling, which some claim will increase with the spread of Internet gaming. Others point to the fact that specific types of Internet gaming may already be illegal under state laws.”

³¹“Internet Gambling: Overview of Federal Criminal Law,” Congressional Research Service, CRS Report No. 97-619A (3/7/00), Summary.

activities of an illegal gambling business involving either the collection of an unlawful debt or a pattern of gambling offenses, 18 U.S.C. §1962 (RICO); (5) launder the proceeds from an illegal gambling business or to plow them back into the business, 18 U.S.C. §1956 (money laundering); or (6) spend more than \$10,000 of the proceeds from an illegal gambling operation at any one time and place, 18 U.S.C. §1957 (money laundering).³²

The NGISC reports that the laws governing gambling in cyberspace are not as clear as they should be, pointing out, for example, that the Interstate Wire Act was written before the Internet was invented. The ability of the Internet to facilitate quick and easy interactions across geographic boundaries makes it difficult to apply traditional notions of state and federal jurisdictions and, some argue, demonstrates the need for additional clarifying legislation.

Yet, there have been a number of successful prosecutions involving Internet gambling. For example, in March 1998, the U.S. Attorney for the Southern District of New York indicted 21 individuals for conspiracy to transmit wagers on sporting events via the Internet, in violation of the Interstate Wire Act of 1961. At that time, U.S. Attorney General Janet Reno stated, "The Internet is not an electronic sanctuary for illegal betting. To Internet betting operators everywhere, we have a simple message, 'You can't hide online and you can't hide offshore.'" Eleven defendants pled guilty and one, Jay Cohen, was found guilty after a jury trial. He was sentenced to 21 months in prison, a two-year supervised release, and a \$5,000 fine.

In 1997, the Attorney General of Minnesota successfully prosecuted Granite Gate Resorts, a Nevada corporation with a Belize-based Internet sports betting operation. The lawsuit alleged that Granite Gate and its president, Kerry Rogers, engaged in deceptive trade practices, false advertising, and consumer fraud by offering Minnesotans access to sports betting, since such betting is illegal under state laws. In 1999, the Minnesota Supreme Court upheld the prosecution. Missouri, New York, and Wisconsin have also successfully prosecuted cases involving Internet gaming.

Given the traditional responsibility of the states regarding gambling, many have been in the forefront of efforts to regulate or prohibit Internet gambling. Several states including Louisiana, Texas, Illinois, and Nevada have introduced or passed legislation specifically prohibiting Internet gambling. Florida has taken an active role, including cooperative efforts with Western Union, to stop money-transfer services for 40 offshore sports books.³³ In 1998, Indiana's Attorney General stated as a policy that a person placing a bet from Indiana with an offshore gaming establishment was engaged in in-state gambling just as if the person engaged in conventional gambling. A number of state attorneys general have initiated court actions against Internet gambling owners and operators, and several have won permanent injunctions.

³²Id.

³³In December 1997, the Attorney General of Florida and Western Union signed an agreement that Western Union would cease providing Quick Pay money transfer services from Florida residents to known offshore gaming establishments. Quick Pay is a reduced-fee system normally used to expedite collection of debts or payment for goods.

Legislation and recommendations. Several states have concluded that only the federal government has the potential to effectively regulate or prohibit Internet gambling. The National Association of Attorneys General has called for an expansion in the language of the federal anti-wagering statute to prohibit Internet gambling and for federal-state cooperation on this issue. A number of Internet gambling bills have been introduced in Congress.

The National Gambling Impact Study Commission report made several recommendations pertaining to Internet gambling, one of which was to encourage foreign governments to reject Internet gambling organizations that prey on U.S. citizens.

The Minority Staff investigation found evidence of a number of foreign banks using their U.S. correspondent accounts to move proceeds related to Internet gambling, including wagers or payments made in connection with Internet gambling websites, deposits made by companies managing Internet gambling operations, and deposits made by companies active in the Internet gambling field in such areas as software development or electronic cash transfer systems. One U.S. bank, Chase Manhattan Bank, was fully aware of Internet gambling proceeds being moved through its correspondent accounts; other U.S. banks were not. Internet gambling issues are addressed in the case histories involving American International Bank, British Trade and Commerce Bank, and Swiss American Bank.

V. Why Correspondent Banking is Vulnerable to Money Laundering

Until the Bank of New York scandal erupted in 1999,³⁴ international correspondent banking had received little attention as a high-risk area for money laundering. In the United States, the general assumption had been that a foreign bank with a valid bank license operated under the watchful eye of its licensing jurisdiction and a U.S. bank had no obligation to conduct its own due diligence. The lesson brought home by the Bank of New York scandal, however, was that some foreign banks carry higher money laundering risks than others, since some countries are seriously deficient in their bank licensing and supervision, and some foreign banks are seriously deficient in their anti-money laundering efforts.

The reality is that U.S. correspondent banking is highly vulnerable to money laundering for a host of reasons. The reasons include: (A) a culture of lax due diligence at U.S. correspondent banks; (B) the role of correspondent bankers or relationship managers; (C) nested correspondents, in which U.S. correspondent accounts are used by a foreign bank's client banks, often without the express knowledge or consent of the U.S. bank; (D) foreign jurisdictions with weak banking or accounting standards; (E) bank secrecy laws; (F) cross border difficulties; and (G) U.S. legal barriers to seizing illicit funds in U.S. correspondent accounts.

³⁴For a description of the Bank of New York scandal, see the appendix.

A. Culture of Lax Due Diligence

The U.S. correspondent banks examined during the investigation operated, for the most part, in an atmosphere of complacency, with lax due diligence, weak controls, and inadequate responses to troubling information.

In initial meetings in January 2000, U.S. banks told the investigation there is little evidence of money laundering through correspondent accounts. Chase Manhattan Bank, which has one of the largest correspondent banking portfolios in the United States, claimed that U.S. banks do not even open accounts for small foreign banks in remote jurisdictions. These representations, which proved to be inaccurate, illustrate what the investigation found to be a common attitude among correspondent bankers -- that money laundering risks are low and anti-money laundering efforts are unnecessary or inconsequential in the correspondent banking field.

Due in part to the industry's poor recognition of the money laundering risks, there is substantial evidence of weak due diligence practices by U.S. banks providing correspondent accounts to foreign banks. U.S. correspondent bankers were found to be poorly informed about the banks they were servicing, particularly small foreign banks licensed in jurisdictions known for bank secrecy or weak banking and anti-money laundering controls. Account documentation was often outdated and incomplete, lacking key information about a foreign bank's management, major business activities, reputation, regulatory history, or anti-money laundering procedures. Monitoring procedures were also weak. For example, it was often unclear who, if anyone, was supposed to be reviewing the monthly account statements for correspondent accounts. At larger banks, coordination was often weak or absent between the correspondent bankers dealing directly with foreign bank clients and other bank personnel administering the accounts, reviewing wire transfer activity, or conducting anti-money laundering oversight. Even though wire transfers were frequently the key activity engaged in by foreign banks, many U.S. banks conducted either no monitoring of wire transfer activity or relied on manual reviews of the wire transfer information to identify suspicious activity. Subpoenas directed at foreign banks or their clients were not always brought to the attention of the correspondent banker in charge of the foreign bank relationship.

Specific examples of weak due diligence practices and inadequate anti-money laundering controls at U.S. correspondent banks included the following.

–Security Bank N.A., a U.S. bank in Miami, disclosed that, for almost two years, it never reviewed for suspicious activity numerous wire transfers totaling \$50 million that went into and out of the correspondent account of a high risk offshore bank called British Trade and Commerce Bank (BTCB), even after questions arose about the bank. These funds included millions of dollars associated with money laundering, financial fraud and Internet gambling. A Security Bank representative also disclosed that, despite an ongoing dialogue with BTCB's president, he did not understand and could not explain BTCB's major business activities, including a high yield investment program promising extravagant returns.

–The Bank of New York disclosed that it had not known that one of its respondent banks, British Bank of Latin America (BBLA), a small offshore bank operating in Colombia and the Bahamas, which moved \$2.7 million in drug money through its correspondent account, had never been examined by any bank regulator. The Bank of New York disclosed further that: (a) despite being a longtime correspondent for banks operating in Colombia, (b) despite 1999 and 2000 U.S. National Money Laundering Strategies’ naming the Colombian black market peso exchange as the largest money laundering system in the Western Hemisphere and a top priority for U.S. law enforcement, and (c) despite having twice received seizure orders for the BBLA correspondent account alleging millions of dollars in drug proceeds laundered through the Colombian black market peso exchange, the Bank of New York had not instituted any special anti-money laundering controls to detect this type of money laundering through its correspondent accounts.

–Several U.S. banks, including Bank of America and Amtrade Bank in Miami, were unaware that their correspondent accounts with American International Bank (AIB), a small offshore bank in Antigua that moved millions of dollars in financial frauds and Internet gambling through its correspondent accounts, were handling transactions for shell foreign banks that were AIB clients. The U.S. correspondent bankers apparently had failed to determine that one of AIB’s major lines of business was to act as a correspondent for other foreign banks, one of which, Caribbean American Bank, was used exclusively for moving the proceeds of a massive advance-fee-for-loan fraud. Most of the U.S. banks had also failed to determine that the majority of AIB’s client accounts and deposits were generated by the Forum, an investment organization that has been the subject of U.S. criminal and securities investigations.

–Bank of America disclosed that it did not know, until tipped off by Minority Staff investigators, that the correspondent account it provided to St. Kitts-Nevis-Anguilla National Bank, a small bank in the Caribbean, was being used to move hundreds of millions of dollars in Internet gambling proceeds. Bank of America had not taken a close look at the source of funds in this account even though this small respondent bank was moving as much as \$115 million in a month and many of the companies named in its wire transfer instructions were well known for their involvement in Internet gambling.

–Citibank correspondent bankers in Argentina indicated that while they opened a U.S. correspondent account for M.A. Bank, an offshore shell bank licensed in the Cayman Islands and operating in Argentina that later was used to launder drug money, and handled the bank’s day-to-day matters, they did not, as a rule, see any monthly statements or monthly activity reports for the bank’s accounts. The Argentine correspondent bankers indicated that they assumed Citibank personnel in New York, who handled administrative matters for the accounts, or Citibank personnel in Florida, who run the bank’s the anti-money laundering unit, reviewed the accounts for suspicious activity. Citibank’s Argentine correspondent bankers indicated, however, that they could not identify specific individuals who reviewed Argentine correspondent accounts for possible money laundering. They also

disclosed that they did not have regular contact with Citibank personnel conducting anti-money laundering oversight of Argentine correspondent accounts, nor did they coordinate any anti-money laundering duties with them.

—When U.S. law enforcement filed a 1998 seizure warrant alleging money laundering violations and freezing millions of dollars in a Citibank correspondent account belonging to M.A. Bank and also filed in court an affidavit describing the frozen funds as drug proceeds from a money laundering sting, Citibank never looked into the reasons for the seizure warrant and never learned, until informed by Minority Staff investigators in 1999, that the frozen funds were drug proceeds.

—Citibank had a ten-year correspondent relationship with Banco Republica, licensed and doing business in Argentina, and its offshore affiliate, Federal Bank, which is licensed in the Bahamas. Citibank's relationship manager for these two banks told the investigation that it "was disturbing" and "shocking" to learn that the Central Bank of Argentina had reported in audit reports of 1996 and 1998 that Banco Republica did not have an anti-money laundering program. When the Minority Staff asked the relationship manager what he had done to determine whether or not there was such a program in place at Banco Republica, he said he was told by Banco Republica management during his annual reviews that the bank had an anti-money laundering program, but he did not confirm that with documentation. The same situation applied to Federal Bank.

—A June 2000 due diligence report prepared by a First Union correspondent banker responsible for an account with a high risk foreign bank called Banque Francaise Commerciale (BFC) in Dominica, contained inadequate and misleading information. For example, only 50% of the BFC documentation required by First Union had been collected, and neither BFC's anti-money laundering procedures, bank charter, nor 1999 financial statement was in the client file. No explanation for the missing documentation was provided, despite instructions requiring it. The report described BFC as engaged principally in "domestic" banking, even though BFC's monthly account statements indicated that most of its transactions involved international money transfers. The report also failed to mention Dominica's weak banking and anti-money laundering controls.

—A number of U.S. banks failed to meet their internal requirements for on-site visits to foreign banks. Internal directives typically require a correspondent banker to visit a foreign bank's offices prior to opening an account for the bank and to pay annual visits thereafter. Such visits are intended, among other purposes, to ensure the foreign bank has a physical presence, to learn more about the bank's management and business activities, and to sell new services. However, in many cases, the required on-site visits were waived, postponed or conducted with insufficient attention to important facts. For example, a Chase Manhattan correspondent banker responsible for 140 accounts said she visited the 25 to 30 banks with the larger accounts each year and visited the rest only occasionally or never. First Union National Bank disclosed that no correspondent banker had visited BFC in

Dominica for three years. Security Bank N.A. disclosed that it had not made any visits to BTCB in Dominica, because Security Bank had only one account on the island and it was not “cost effective” to travel there. In still another instance, Citibank opened a correspondent account for M.A. Bank, without traveling to either the Cayman Islands where the bank was licensed or Uruguay where the bank claimed to have an “administrative office.” Instead, Citibank traveled to Argentina and visited offices belonging to several firms in the same financial group as M.A. Bank, apparently deeming that trip equivalent to visiting M.A. Bank’s offices. Citibank even installed wire transfer software for M.A. Bank at the Argentine site, although M.A. Bank has no license to conduct banking activities in Argentina and no office there. Despite repeated requests, Citibank has indicated that it remains unable to inform the investigation whether or not M.A. Bank has an office in Uruguay. The investigation has concluded that M.A. Bank is, in fact, a shell bank with no physical presence in any jurisdiction.

—Harris Bank International, a New York bank specializing in correspondent banking and international wire transfers, told the investigation that it had no electronic means for monitoring the hundreds of millions of dollars in wire transfers it processes each day. Its correspondent bankers instead have to conduct manual reviews of account activity to identify suspicious activity. The bank said that it had recently allocated funding to purchase its first electronic monitoring software capable of analyzing wire transfer activity for patterns of possible money laundering.

Additional Inadequacies with Non-Credit Relationships. In addition to the lax due diligence and monitoring controls for correspondent accounts in general, U.S. banks performed particularly poor due diligence reviews of high risk foreign banks where no credit was provided by the U.S. bank. Although often inadequate, U.S. banks obtain more information and pay more attention to correspondent relationships involving the extension of credit where the U.S. bank’s assets are at risk than when the U.S. bank is providing only cash management services on a fee basis.³⁵ U.S. banks concentrate their due diligence efforts on their larger correspondent accounts and credit relationships and pay significantly less attention to smaller accounts involving foreign banks and where only cash management services are provided.

Money launderers are primarily interested in services that facilitate the swift and anonymous movement of funds across international lines. These services do not require credit relationships, but can be provided by foreign banks with access to wire transfers, checks and credit cards. Money launderers may even prefer small banks in non-credit correspondent relationships since they attract less scrutiny from their U.S. correspondents. Foreign banks intending to launder funds may choose to limit their correspondent relationships to non-credit services to avoid scrutiny

³⁵ A correspondent bank’s analysis of credit risk does not necessarily include the risk of money laundering; rather it is focused on the risk of monetary loss to the correspondent bank, and the two considerations can be very different. For example, one correspondent bank examined in the investigation clearly rejected a credit relationship with a respondent bank due to doubts about its investment activities, but did not hesitate to continue providing it with cash management services such as wire transfers.

and move money quickly, with few questions asked.

Under current practice in the United States, high-risk foreign banks in non-credit correspondent relationships seem to fly under the radar screen of U.S. banks conducting due diligence reviews. Yet from an anti-money laundering perspective, these are precisely the banks which – if they hold an offshore license, conduct a shell operation, move large sums of money across international lines, or demonstrate other high risk factors – warrant heightened scrutiny.

Specific examples of the different treatment that U.S. banks afforded to foreign banks in non-credit relationships included the following.

–One Chase Manhattan correspondent banker said that she did not review the annual audited financial statement of a foreign bank in a non-credit relationship. Another Chase Manhattan representative described Chase’s attitude towards non-credit correspondent relationships as “essentially reactive” and said there was no requirement to make an annual visit to bank clients in non-credit relationships.

–Bank of America representatives said that most small correspondent bank relationships were non-credit in nature, Bank of America “has lots” of these, it views them as “low risk,” and such relationships do not require an annual review of the respondent bank’s financial statements.

–One bank that maintained a non-credit correspondent relationship for a year with American International Bank (AIB), an offshore bank which used its correspondent accounts to move millions of dollars connected to financial frauds and Internet gambling, sought significantly more due diligence information when AIB requested a non-secured line of credit. To evaluate the credit request, the correspondent bank asked AIB to provide such information as a list of its services; a description of its marketing efforts; the total number of its depositors and “a breakdown of deposits according to maturities”; a description of AIB management’s experience “in view of the fact that your institution has been operating for only one year”; a “profile of the regulatory environment in Antigua”; the latest financial statement of AIB’s parent company; and information about certain loan transactions between AIB and its parent. Apparently none of this information was provided a year earlier when the bank first established a non-credit correspondent relationship with AIB.

–A Security Bank representative reported that when he encountered troubling information about British Trade and Commerce Bank, a bank that used its correspondent accounts to move millions of dollars connected with financial frauds, he decided against extending credit to the bank, but continued providing it with cash management services such as wire transfers, because he believed a non-credit relationship did not threaten Security Bank with any monetary loss.

Inadequate Responses to Troubling Information. While some U.S. banks never learned of questionable activities by their foreign bank clients, when troubling information did reach a U.S. correspondent banker, in too many cases, the U.S. bank took little or no action in response. For example:

–Citibank left open a correspondent account belonging to M.A. Bank and allowed hundreds of millions of dollars to flow through it, even after receiving a seizure order from U.S. law enforcement alleging drug money laundering violations and freezing \$7.7 million deposited into the account. Citibank also failed to inquire into the circumstances surrounding the seizure warrant and, until informed by Minority Staff investigators, failed to learn that the funds were drug proceeds from a money laundering sting.

–Chase Manhattan Bank left open a correspondent account with Swiss American Bank (SAB), an offshore bank licensed in Antigua and Barbuda, even after SAB projected that it would need 10,000 checks per month and began generating monthly bank statements exceeding 200 pages in length to process millions of dollars in Internet gambling proceeds.

–First Union National Bank left open a money market account with British Trade and Commerce Bank (BTCB) for almost 18 months after receiving negative information about the bank. When millions of dollars suddenly moved through the account eight months after it was opened, First Union telephoned BTCB and asked it to voluntarily close the account. When BTCB refused, First Union waited another nine months, replete with troubling incidents and additional millions of dollars moving through the account, before it unilaterally closed the account.

–When Citibank was asked by the Central Bank of Argentina for information about the owners of Federal Bank, an offshore bank licensed in the Bahamas with which Citibank had a ten year correspondent relationship, Citibank responded that its “records contain no information that would enable us to determine the identity of the shareholders of the referenced bank.” Citibank gave this response to the Central Bank despite clear information in its own records identifying Federal Bank’s owners. When the Minority Staff asked the relationship manager to explain Citibank’s response, the relationship manager said he had the impression that the Central Bank “was trying to play some kind of game,” that it was “trying to get some legal proof of ownership.” After further discussion, the relationship manager said that he now knows Citibank should have answered the letter “in a different way” and that Citibank “should have done more.”

The investigation saw a number of instances in which U.S. banks were slow to close correspondent accounts, even after receiving ample evidence of misconduct. When asked why it took so long to close an account for Swiss American Bank after receiving troubling information about the bank, Chase Manhattan Bank representatives explained that Chase had solicited Swiss American as a client and felt “it wasn’t ethical to say we’ve changed.” Chase personnel told the investigation, we “couldn’t leave them.” Bank of America explained its delay in closing a

correspondent account as due to fear of a lawsuit by the foreign bank seeking damages for hurting its business if the account were closed too quickly. A First Union correspondent banker expressed a similar concern, indicating that it first asked BTCB to close its account voluntarily so that First Union could represent that the decision had been made by the customer and minimize its exposure to litigation. The Minority Staff found this was not an uncommon practice, even though the investigation did not encounter any instance of a foreign bank's filing such a suit.

B. Role of Correspondent Bankers

Correspondent bankers, also called relationship managers, should serve as the first line of defense against money laundering in the correspondent banking field, but many appear to be inadequately trained and insufficiently sensitive to the risk of money laundering taking place through the accounts they manage. These deficiencies are attributable, in part, to the industry's overall poor recognition of money laundering problems in correspondent banking.

The primary mission of most correspondent bankers is to expand business – to open new accounts, increase deposits and sell additional services to existing accounts. But many are also expected to execute key anti-money laundering duties, such as evaluating prospective bank clients and reporting suspicious activity. Those correspondent bankers are, in effect, being asked to fill contradictory roles – to add new foreign banks as clients, while maintaining a skeptical stance toward those same banks and monitoring them for suspicious activity. The investigation found that some banks compensate their correspondent bankers by the number of new accounts they open or the amount of money their correspondent accounts bring into the bank. The investigation found few rewards, however, for closing suspect accounts or filing suspicious activity reports. In fact, the financial incentive is just the opposite; closing correspondent accounts reduces a bank's income and can reduce a correspondent banker's compensation. The result was that a correspondent banker's anti-money laundering duties were often a low priority.

For example, the Bank of America told the Minority Staff investigation that their relationship managers used to be seen as sales officers, routinely seeking new accounts, maintaining a "positive sales approach," and signing up as many correspondent banks as possible. Bank of America's attitude in the early and middle 1990s, it said, was that "banks are banks" and "you can trust them." The bank said it has since changed its approach and is no longer "beating the bushes" for new correspondent relationships.

Even if correspondent bankers were motivated to watch for signs of money laundering in their accounts, the investigation found that most did not have the tools needed for effective oversight. Large correspondent banks in the United States operate two or three thousand correspondent accounts at a time and process billions of dollars of wire transactions each day. Yet until very recently, most U.S. banks did not invest in the software, personnel or training needed to identify and manage money laundering risks in correspondent banking. For example, U.S. correspondent bankers reported receiving limited anti-money laundering training and seemed to have little awareness of the money laundering methods, financial frauds and other wrongdoing that

rogue foreign banks or their clients perpetrate through correspondent accounts.³⁶ Standard due diligence forms were sometimes absent or provided insufficient guidance on the initial and ongoing due diligence information that correspondent bankers should obtain. Coordination between correspondent bankers and anti-money laundering bank personnel was often lacking. Automated systems for reviewing wire transfer activity were usually not available. Few banks had pro-active anti-money laundering programs in place to detect and report suspect activity in correspondent accounts. The absence of effective anti-money laundering tools is further evidence of the low priority assigned to this issue in the correspondent banking field.

Examples of correspondent bankers insufficiently trained and equipped to identify and report suspicious activity included the following.

–A Bank of New York relationship manager told the investigation that there had been little anti-money laundering training for correspondent banking, but it is “in the developmental stages now.” The head of Bank of New York’s Latin American correspondent banking division disclosed that she had received minimal information about the black market peso exchange and was unaware of its importance to U.S. law enforcement. She also said the bank had not instituted any means for detecting this type of money laundering, nor had it instructed its respondent banks to watch for this problem and refuse wire transfers from money changers involved in the black market.

–A Chase Manhattan Bank relationship manager who handled 140 correspondent accounts told the investigation that she had received no anti-money laundering training during her employment at Chase Manhattan or her prior job at Chemical Bank; she was not trained in due diligence analysis; the bank had no standard due diligence forms; and she received no notice of countries in the Caribbean to which she should pay close attention when opening or monitoring a correspondent banking relationship.

-- A Bank of America official said that anti-money laundering training had received little attention for several years as the bank underwent a series of mergers. The bank said it is now improving its efforts in this area.

–A relationship manager at the Miami office of Banco Industrial de Venezuela told the investigation that she had received no training in recognizing possible financial frauds being committed through foreign bank correspondent accounts and never suspected fraudulent activity might be a problem. She indicated that, even after several suspicious incidents involving a multi-million-dollar letter of credit, a proof of funds letter discussing a prime bank guarantee, repeated large cash withdrawals by the respondent bank’s

³⁶The case histories in this report provide specific examples of how rogue foreign banks or their clients are using U.S. correspondent account to launder funds or facilitate crime, including from drug trafficking, prime bank guarantees, high yield investment scams, advanced-fee-for-loan scams, stock fraud, Internet gambling and tax evasion. Correspondent bankers appear to receive little or no training in recognizing and reporting suspicious activity related to such correspondent banking abuses.

employees, and expressions of concern by her superiors, no one at the bank explained the money laundering risks to her or instructed her to watch the relationship.

A few banks have developed new and innovative anti-money laundering controls in their correspondent banking units, including wire transfer monitoring software and pro-active reviews of correspondent bank activity. A number of the banks surveyed or interviewed by the Minority Staff expressed new interest in developing stronger due diligence and monitoring procedures for correspondent accounts. But most of the U.S. banks contacted during the investigation had not devoted significant resources to help their correspondent bankers detect and report possible money laundering.

C. Nested Correspondents

Another practice in U.S. correspondent banking which increases money laundering risks in the field is the practice of foreign banks operating through the U.S. correspondent accounts of other foreign banks. The investigation uncovered numerous instances of foreign banks gaining access to U.S. banks -- not by directly opening a U.S. correspondent account -- but by opening an account at another foreign bank which, in turn, has an account at a U.S. bank. In some cases, the U.S. bank was unaware that a foreign bank was "nested" in the correspondent account the U.S. bank had opened for another foreign bank; in other cases, the U.S. bank not only knew but approved of the practice. In a few instances, U.S. banks were surprised to learn that a single correspondent account was serving as a gateway for multiple foreign banks to gain access to U.S. dollar accounts, U.S. wire transfer systems and other services available in the United States.

Examples uncovered during the investigation included the following.

—In 1999, First Union National Bank specifically rejected a request by a Dominican bank, British Trade and Commerce Bank (BTCB), to open a U.S. correspondent account. First Union was unaware, until informed by Minority Staff investigators, that it had already been providing wire transfer services to BTCB for two years, through BTCB's use of a First Union correspondent account belonging to Banque Francaise Commerciale (BFC). BFC is a Dominican bank which had BTCB as a client.

—A Chase Manhattan Bank correspondent banker said that she was well aware that American International Bank (AIB) was allowing other foreign banks to utilize its Chase account. She said that she had no problem with the other banks using AIB's correspondent account, since she believed they would otherwise have no way to gain entry into the U.S. financial system. She added that she did not pay any attention to the other foreign banks doing business with AIB and using its U.S. account. One of the banks using AIB's U.S. account was Caribbean American Bank, a bank used exclusively for moving the proceeds of a massive advance-fee-for-loan fraud.

—The president of Swiss American Bank in Antigua said that no U.S. bank had ever asked

SAB about its client banks, and SAB had, in fact, allowed at least two other offshore banks to use SAB's U.S. accounts.

—Harris Bank International in New York said that its policy was not to ask its respondent banks about their bank clients. Harris Bank indicated, for example, that it had a longstanding correspondent relationship with Standard Bank Jersey Ltd., but no information on Standard Bank's own correspondent practices. Harris Bank disclosed that it had been unaware that, in providing correspondent services to Standard Bank, it had also been providing correspondent services to Hanover Bank, a shell bank which, in 1998 alone, handled millions of dollars associated with financial frauds. Hanover Bank apparently would not have met Harris Bank's standards for opening an account directly, yet it was able to use Harris Bank's services through Standard Bank. Harris Bank indicated that it still has no information on what foreign banks may be utilizing Standard Bank's U.S. correspondent account, and it has no immediate plans to find out.

Case histories on American International Bank, Hanover Bank, and British Trade and Commerce Bank demonstrate how millions of dollars can be and have been transferred through U.S. correspondent accounts having no direct links to the foreign banks moving the funds. Despite the money laundering risks involved, no U.S. bank contacted during the investigation had a policy or procedure in place requiring its respondent banks to identify the banks that would be using its correspondent account, although Harris Bank International said it planned to institute that policy for its new bank clients and, during a Minority Staff interview, Bank of America's correspondent banking head stated "it would make sense to know a correspondent bank's correspondent bank customers."

D. Foreign Jurisdictions with Weak Banking or Accounting Practices

International correspondent accounts require U.S. banks to transact business with foreign banks. U.S. correspondent banks are inherently reliant, in part, on foreign banking and accounting practices to safeguard them from money laundering risks in foreign jurisdictions. Weak banking or accounting practices in a foreign jurisdiction increase the money laundering risks for U.S. correspondent banks dealing with foreign banks in that jurisdiction.

Weak Foreign Bank Licensing or Supervision. The international banking system is built upon a hodge podge of differing bank licensing and supervisory approaches in the hundreds of countries that currently participate in international funds transfer systems. It is clear that some financial institutions operate under substantially less stringent requirements and supervision than others. It is also clear that jurisdictions with weak bank licensing and supervision offer more attractive venues for money launderers seeking banks to launder illicit proceeds and move funds

into bank accounts in other countries.³⁷

Licensing requirements for new banks vary widely. While some countries require startup capital of millions of dollars in cash reserves deposited with a central bank and public disclosure of a bank's prospective owners, other countries allow startup capital to be kept outside the country, impose no reserve requirements, and conceal bank ownership. Regulatory requirements for existing banks also differ. For example, while some countries use government employees to conduct on-site bank examinations, collect annual fees from banks to finance oversight, and require banks to operate anti-money laundering programs, other countries conduct no bank examinations and collect no fees for oversight, instead relying on self-policing by the country's banking industry and voluntary systems for reporting possible money laundering activities.

Offshore banking has further increased banking disparities. Competition among jurisdictions seeking to expand their offshore banking sectors has generated pressure for an international "race to the bottom" in offshore bank licensing, fees and regulation. Domestic bank regulators appear willing to enact less stringent rules for their offshore banks, not only to respond to the competitive pressure, but also because they may perceive offshore banking rules as having little direct impact on their own citizenry since offshore banks are barred from doing business with the country's citizens. Domestic bank regulators may also have less incentive to exercise careful oversight of their offshore banks, since they are supposed to deal exclusively with foreign citizens and foreign currencies. A number of countries, including in the East Caribbean and South Pacific, have developed separate regulatory regimes for their onshore and offshore banks, with less stringent requirements applicable to the offshore institutions.

The increased money laundering risks for correspondent banking are apparent, for example, in a web site sponsored by a private firm urging viewers to open a new bank in the Republic of Montenegro. The web site trumpets not only the jurisdiction's minimal bank licensing requirements, but also its arrangements for giving new banks immediate access to international correspondent accounts.

"If you're looking to open a **FULLY LICENSED BANK** which is authorized to carry on all banking business worldwide, the **MOST ATTRACTIVE JURISDICTION** is currently the **REPUBLIC OF MONTENEGRO**. ... JUST USD\$9,999 for a full functioning bank (plus USD \$4,000 annual fees) No large capital requirements – just USD\$10,000 capital gets your Banking License (and which you get **IMMEDIATELY BACK** after the Bank is ... set-up)[.] ... [N]o intrusive background checks! ... The basic package includes opening a **CORRESPONDENT BANK [ACCOUNT]** at the Bank of Montenegro. This allows the new bank to use their existing correspondent network which includes Citibank, Commerzbank, Union Bank of Switzerland etc[.] for sending and receiving payments. For additional fee we can arrange direct **CORRESPONDENT ACCOUNTS** with banks in

³⁷See, for example, discussion of "Offshore Financial Centers," INCSR 2000, at 565-77.

other countries.”³⁸ [Emphasis and capitalization in original text.]

A similar web site offers to provide new banks licensed in Montenegro with a correspondent account not only at the “State Bank of Montenegro,” but also at a “Northern European Bank.”³⁹ When contacted, Citibank’s legal counsel indicated no awareness of the web sites or of how many banks may be transacting business through its Bank of Montenegro correspondent account.

Weak Foreign Accounting Practices. Working in tandem with banking requirements are accounting standards which also vary across international lines. Accountants are often key participants in bank regulatory regimes by certifying the financial statements of particular banks as in line with generally accepted accounting principles. Government regulators and U.S. banks, among others, rely on these audited financial statements to depict a bank’s earnings, operations and solvency. Accountants may also perform bank examinations or special audits at the request of government regulators. They may also be appointed as receivers or liquidators of banks that have been accused of money laundering or other misconduct.

The investigation encountered a number of instances in which accountants in foreign countries refused to provide information about a bank’s financial statements they had audited or about reports they had prepared in the role of a bank receiver or liquidator. Many foreign accountants contacted during the investigation were uncooperative or even hostile when asked for information.

-- The Dominican auditing firm of Moreau Winston & Company, for example, refused to provide any information about the 1998 financial statement of British Trade and Commerce Bank, even though the financial statement was a publicly available document published in the country’s official gazette, the firm had certified the statement as accurate, and the statement contained unusual entries that could not be understood without further explanation.

--A PriceWaterhouseCoopers auditor in Antigua serving as a government-appointed liquidator for Caribbean American Bank (CAB) refused to provide copies of its reports on CAB’s liquidation proceedings, even though the reports were filed in court, they were supposed to be publicly available, and the Antiguan government had asked the auditor to provide the information to the investigation.⁴⁰

³⁸See global-money.com/offshore/europe-montenegro_bank.html. See also web.offshore.by.net/~unitrust/enmontenegrobank.html and www.permanenttourist.com/offshore-montenegro-bank.html.

³⁹www.permanenttourist.com/offshore-montenegro-bank.html.

⁴⁰See correspondence on CAB between the Minority Staff, the PriceWaterhouseCoopers auditor and the auditor's legal counsel in the case study on American International Bank.

—Another Antiguan accounting firm, Pannell Kerr Foster, issued an audited financial statement for Overseas Development Bank and Trust in which the auditor said certain items could not be confirmed because the appropriate information was not available from another bank, American International Bank. Yet Pannell Kerr Foster was also the auditor of American International Bank, with complete access to that bank's financial records.

The investigation also came across disturbing evidence of possible conflicts of interest involving accountants and the banks they audited, and of incompetent or dishonest accounting practices. In one instance, an accounting firm verified a \$300 million item in a balance sheet for British Trade and Commerce Bank that, when challenged by Dominican government officials, has yet to be substantiated. In another instance, an accounting firm approved an offshore bank's financial statements which appear to have concealed indications of insolvency, insider dealing and questionable transactions. In still another instance raising conflict of interest concerns, an accountant responsible for auditing three offshore banks involving the same bank official provided that bank official with a letter of reference, which the official then used to help one of the banks open a U.S. correspondent account.

U.S. correspondent bankers repeatedly stated that they attached great importance to a foreign bank's audited financial statements in helping them analyze the foreign bank's operations and solvency. Weak foreign accounting practices damage U.S. correspondent banking by enabling rogue foreign banks to use inaccurate and misleading financial statements to win access to U.S. correspondent accounts.

International banking and accounting organizations, such as the International Monetary Fund, Basle Committee for Banking Supervision, and International Accounting Standards Committee, have initiated efforts to standardize and strengthen banking and accounting standards across international lines. A variety of published materials seek to improve fiscal transparency, bank licensing and supervision, and financial statements, among other measures. For the foreseeable future, however, international banking and accounting variations are expected to continue, and banks will continue to be licensed by jurisdictions with weak banking and accounting practices. The result is that foreign banks operating without adequate capital, without accurate financial statements, without anti-money laundering programs, or without government oversight will be knocking at the door of U.S. correspondent banks.

U.S. correspondent banks varied widely in the extent to which they took into account a foreign country's banking and anti-money laundering controls in deciding whether to open an account for a foreign bank. Some U.S. banks did not perform any country analysis when deciding whether to open a foreign bank account. Several U.S. correspondent bankers admitted opening accounts for banks in countries about which they had little information. Other U.S. banks performed country evaluations that took into account a country's stability and credit risk, but not its reputation for banking or anti-money laundering controls. Still other U.S. banks performed extensive country evaluations that were used only when opening accounts for foreign banks requesting credit. On the other hand, a few banks, such as Republic National Bank of New York,

explicitly required their correspondent bankers to provide information about a country's reputation for banking supervision and anti-money laundering controls on the account opening documentation, and routinely considered that information in deciding whether to open an account for a foreign bank.

E. Bank Secrecy

Bank secrecy laws further increase money laundering risks in international correspondent banking. Strict bank secrecy laws are a staple of many countries, including those with offshore banking sectors. Some jurisdictions refuse to disclose bank ownership. Some refuse to disclose the results of bank examinations or special investigations. Other jurisdictions prohibit disclosure of information about particular bank clients or transactions, sometimes refusing to provide that information to correspondent banks and foreign bank regulators.

The Minority Staff identified several areas where bank secrecy impedes anti-money laundering efforts. One area involves secrecy surrounding bank ownership. In a case involving Dominica, for example, government authorities were legally prohibited from confirming a Dominican bank's statements to a U.S. bank concerning the identity of the Dominican bank's owners. In a case involving the South Pacific island of Vanuatu, bank ownership secrecy impeded local oversight of offshore banks. A local bank owner, who also served as chairman of Vanuatu's key commission regulating offshore banks, was interviewed by Minority Staff investigators. He indicated that Vanuatu law prohibited government officials from disclosing bank ownership information to non-government personnel so that, even though he chaired a key offshore bank oversight body, he was not informed about who owned the 60 banks he oversaw. When asked who he thought might own the offshore banks, he speculated that the owners were wealthy individuals, small financial groups or, in a few cases, foreign banks, but stressed he had no specific information to confirm his speculation.

Another area involves secrecy surrounding bank examinations, audits and special investigations. In several cases, government authorities said they were prohibited by law or custom from revealing the results of bank examinations, even for banks undergoing liquidation or criminal investigations. Bank regulators in Jersey, for example, declined to provide a special report that resulted in the censure of Standard Bank Jersey Ltd. for opening a correspondent account for Hanover Bank, because the Jersey government did not routinely disclose findings of fact or documents accumulated through investigations. The United Kingdom refused a request to describe the results of a 1993 inquiry into a £20 million scandal involving Hanover Bank and a major British insurance company, even though the inquiry had gone on for years, resulted in official findings and recommendations, and involved a closed matter. U.S. government authorities were also at times uncooperative, declining, for example, to disclose information related to Operation Risky Business, a Customs undercover operation that exposed a \$60 million fraud perpetrated through two foreign banks and multiple U.S. correspondent accounts. Bank examinations, audits and investigations that cannot be released or explained in specific terms hinder international efforts to gather accurate information about suspect financial institutions,

companies and individuals.

A third area involves secrecy of information related to specific bank clients and transactions. When Minority Staff investigators sought to trace transactions and bank accounts related to individuals or entities either convicted of or under investigation for wrongdoing in the United States, foreign banks often declined to answer specific questions about their accounts and clients, citing their country's bank secrecy laws. When asked whether particular accounts involved Internet gambling, the same answer was given. When asked about whether funds distributed to correspondent bank officials represented insider dealing, the same answer was given.

Bank secrecy laws contribute to money laundering by blocking the free flow of information needed to identify rogue foreign banks and individual wrongdoers seeking to misuse the correspondent banking system to launder illicit funds. Bank secrecy laws slow law enforcement and regulatory efforts. Bank secrecy laws also make it difficult for U.S. banks considering correspondent bank applications to make informed decisions about opening accounts or restricting certain depositors or lines of business. Money launderers thrive in bank secrecy jurisdictions that hinder disclosure of their accounts and activities, even when transacting business through U.S. correspondent accounts.

F. Cross Border Difficulties

Due diligence reviews of foreign banks, if performed correctly, require U.S. correspondent banks to obtain detailed information from foreign jurisdictions. This information is often difficult to obtain. For example, some governments are constrained by bank secrecy laws from providing even basic information about the banks operating in the country. Jurisdictions with weak banking oversight and anti-money laundering regimes may have little useful information to offer in response to an inquiry by a U.S. based bank. Jurisdictions reliant on offshore businesses for local jobs or government fees may be reluctant to disclose negative information. Other sources of information may be limited or difficult to evaluate. Many foreign jurisdictions have few or no public databases about their banks. Court records may not be computerized or easily accessible. Credit agencies may not operate within the jurisdiction. Media databases may be limited or nonexistent. Language barriers may impose additional difficulties. Travel to foreign jurisdictions by U.S. correspondent bankers to gather first-hand information is costly and may not produce immediate or accurate information, especially if a visit is short or to an unfamiliar place. The bottom line is that due diligence is not easy in international correspondent banking.

The difficulty continues after a correspondent account with a foreign bank is opened. Correspondent banking with foreign banks, by necessity, involves transactions across international lines. The most common correspondent banking transaction is a wire transfer of funds from one country to another. Foreign exchange transactions, including clearing foreign checks or credit card transactions, and international trade transactions are also common. All require tracing transactions from one financial institution to another, usually across international borders, and involve two or more jurisdictions, each with its own administrative and statutory regimes. These cross border

financial transactions inevitably raise questions as to which jurisdiction's laws prevail, who is responsible for conducting banking and anti-money laundering oversight, and what information may be shared to what extent with whom. Cross border complexities increase the vulnerability of correspondent banking to money laundering by rendering due diligence more difficult, impeding investigations of questionable transactions, and slowing bank oversight.

G. U.S. Legal Barriers to Seizing Funds in U.S. Correspondent Accounts

Another contributor to money laundering in correspondent banking are U.S. legal barriers to the seizure of laundered funds from a U.S. correspondent bank account.

Under current law in the United States, funds deposited into a correspondent bank account belong to the respondent bank that opened and has signatory authority over the account; the funds do not belong to the respondent bank's individual depositors.⁴¹ Federal civil forfeiture law, under 18 U.S.C. 984, generally prohibits the United States from seizing suspect funds from a respondent bank's correspondent account based upon the wrongdoing of an individual depositor at the respondent bank. The one exception, under 18 U.S.C. 984(d), is if the United States demonstrates that the bank holding the correspondent account "knowingly engaged" in the laundering of the funds or in other criminal misconduct justifying seizure of the bank's own funds.

Few cases describe the level of bank misconduct that would permit a seizure of funds from a U.S. correspondent account under Section 984(d). One U.S. district court has said that the United States must demonstrate the respondent bank's "knowing involvement" or "willful blindness" to the criminal misconduct giving rise to the seizure action.⁴² That court upheld a forfeiture complaint alleging that the respondent bank had written a letter of reference for the wrongdoer, handled funds used to pay ransom to kidnappers, and appeared to be helping its clients avoid taxes, customs duties and transaction reporting requirements. The court found that, "under the totality of the circumstances ... the complaint sufficiently allege[d] [the respondent bank's] knowing involvement in the scheme."

Absent such a showing by the United States, a respondent bank may claim status as an "innocent bank" and no funds may be seized from its U.S. correspondent account. If a foreign bank successfully asserts an innocent bank defense, the United States' only alternative is to take legal action in the foreign jurisdiction where the suspect funds were deposited. Foreign litigation is, of course, more difficult and expensive than seizure actions under U.S. law and may require a greater threshold of wrongdoing before it will be undertaken by the United States government.

In some instances, money launderers may be deliberately using correspondent accounts to

⁴¹See, for example, United States v. Proceeds of Drug Trafficking Transferred to Certain Foreign Bank Accounts (Civil Action No. 98-434(NHJ), U.S. District Court for the District of Columbia 2000), court order dated 4/11/00.

⁴²United States v. \$15,270,885.69 (2000 U.S. Dist. LEXIS 12602, 2000 WL 1234593 SDNY 2000).

hinder seizures by U.S. law enforcement, and some foreign banks may be taking advantage of the innocent bank doctrine to shield themselves from the consequences of lax anti-money laundering oversight. For example, there are numerous criminal investigations in the United States of frauds committed by Nigerian nationals and their accomplices involving suspect funds deposited into U.S. correspondent accounts in the name of Nigerian banks.

Nigerian financial fraud cases are a well known, widespread problem which consumes significant U.S. law enforcement and banking resources. The INCSR 2000 report states:

“Nigeria continues to be the money laundering and financial fraud hub of West Africa, and may be assuming that role for the entire continent. Nigerian money launderers operate sophisticated global networks to repatriate illicit proceeds Nigerian Advance Fee Fraud has arguably become the most lucrative financial crime committed by Nigerian criminals worldwide, with conservative estimates indicating hundred of millions of dollars in illicit profits generated annually. This type of fraud is referred to internationally as ‘Four-One-Nine’ (419), referring to the Nigerian criminal statute for fraud, and has affected a large number of American citizens and businesses.”⁴³

U.S. prosecutors seeking to recover Nigerian 4-1-9 fraud proceeds face serious legal hurdles if the funds have been deposited into a Nigerian bank’s U.S. correspondent account. Section 984(d) precludes seizure of the funds from the correspondent account unless the United States demonstrates that the Nigerian bank was knowingly engaged in misconduct. Demonstrating Nigerian bank misconduct is not an easy task; Nigerian bank information is not readily available and prosecutors would likely have to travel to Nigeria to obtain documents or interview bank personnel. Law enforcement advised that these legal and investigatory complications make U.S. prosecutors reluctant to pursue 4-1-9 cases, that Nigerian wrongdoers are well aware of this reluctance, and that some Nigerians appear to be deliberately using U.S. correspondent accounts to help shield their ill-gotten gains from seizure by U.S. authorities.

The survey conducted by the investigation discovered that at least two U.S. banks have numerous correspondent relationships with Nigerian banks, one listing 34 such correspondent relationships and the other listing 31. The investigation also determined that many of these Nigerian banks were newly established, there was little information readily available about them, and the only method to obtain first hand information about them was to travel to Nigeria. These U.S. correspondent accounts increase money laundering risks in U.S. correspondent banking, not only because of Nigeria’s poor anti-money laundering and banking controls, but also because of

⁴³INCSR 2000 at 713. The INCSR 2000 report also expresses concern about Nigeria’s weak anti-money laundering efforts, which was echoed by international banking experts interviewed by Minority Staff investigators. The Federal Deposit Insurance Corporation recently issued a special alert urging U.S. financial institutions to scrutinize transactions to avoid funds associated with Nigerian frauds. FDIC Financial Institution Letter No. FIL-64-2000 (9/19/00). See also, for example, “Letters from Lagos promise false riches for the gullible,” The Times (London) (8/20/99); “Nigerian Con Artists Netting Millions in Advance-Fee Schemes,” Los Angeles Times (1/24/98).

U.S. legal protections that shield these accounts from seizures of suspect funds.

The special forfeiture protections in U.S. law for deposits into correspondent accounts are not available for deposits into any other type of account at U.S. banks. Additional examples of U.S. legal barriers impeding forfeiture of illicit proceeds from U.S. correspondent accounts are discussed in the case histories involving European Bank, British Bank of Latin America, and British Trade and Commerce Bank.

VI. How an Offshore Bank Lauanders Money Through a U.S. Correspondent Account: The Lessons of Guardian Bank

In March 2000, the Minority Staff conducted an in-depth interview of a former offshore bank owner who had pled guilty to money laundering in the United States and was willing to provide an insider's account of how his bank used U.S. correspondent accounts to launder funds and facilitate crime in the United States.

Guardian Bank and Trust (Cayman) Ltd. was an offshore bank licensed by the Cayman Islands which opened its doors in 1984 and operated for about ten years before being closed by the Cayman government. At its peak, Guardian Bank had a physical office in the Cayman Islands' capital city, over 20 employees, over 1,000 clients, and about \$150 million in assets. The bank operated until early 1995, when it was abruptly closed by Cayman authorities and eventually turned over to a government-appointed liquidator due to "'serious irregularities' identified in the conduct of the Offshore Bank's business."⁴⁴

The majority owner and chief executive of Guardian Bank for most of its existence was John Mathewson, a U.S. citizen who was then a resident of the Cayman Islands. In 1996, while in the United States, Mathewson was arrested and charged with multiple counts of money laundering, tax evasion and fraud, and later pleaded guilty.⁴⁵ As part of his efforts to cooperate with federal law enforcement, Mathewson voluntarily provided the United States with an electronic ledger and rolodex providing detailed records for a one year period of all Guardian Bank customers, accounts and transactions.

The encrypted computer tapes provided by Mathewson represent the first and only time

⁴⁴Johnson v. United States, 971 F.Supp. 862, 863 (U.S. District Court for the District of New Jersey 1997).

⁴⁵In 1997, Mathewson pleaded guilty to charges in three federal prosecutions. The U.S. District of New Jersey had indicted him on three counts of money laundering, United States v. Mathewson (Criminal Case No. 96-353-AJL); the Eastern District of New York had charged him with four counts of aiding and abetting the evasion of income tax, United States v. Mathewson (Criminal Case No. 97-00189-001-ALJ); and the Southern District of Florida had charged him with one count of conspiracy to commit wire fraud, United States v. Mathewson (Criminal Case No. 97-0188-Marcus). He was also subject to a 1993 civil tax judgment for over \$11.3 million from United States v. Mathewson (U.S. District Court for the Southern District of Florida Civil Case No. 92-1054-Davis).

U.S. law enforcement officials have gained access to the computerized records of an offshore bank in a bank secrecy haven.⁴⁶ Mathewson not only helped decode the tapes, but also explained the workings of his bank, and provided extensive and continuing assistance to federal prosecutors in securing criminal convictions of his former clients for tax evasion, money laundering and other crimes.⁴⁷

Mathewson stated at his sentencing hearing, “I have no excuse for what I did in aiding U.S. Citizens to evade taxes, and the fact that every other bank in the Caymans was doing it is no excuse. ... But I have cooperated.” His cooperation has reportedly resulted in the collection of more than \$50 million in unpaid taxes and penalties, with additional recoveries possible.⁴⁸ One prosecutor has characterized Mathewson’s assistance as “the most important cooperation for the Government in the history of tax haven prosecution.”⁴⁹

Pursuant to his plea agreement to provide assistance to government officials investigating matters related to Guardian Bank, Mathewson provided the Minority Staff investigation with a lengthy interview and answers to written questions on how Guardian Bank laundered funds through its U.S. correspondent accounts.

⁴⁶The government-appointed liquidator of Guardian Bank sued unsuccessfully to recover the computer tapes from the U.S. government, arguing that they had been improperly obtained and disclosure of the bank information would violate Cayman confidentiality laws and damage the reputation of the Cayman banking industry. *Johnson v. United States*, 971 F. Supp. 862 (U.S. District Court for the District of New Jersey 1997). The Cayman government also refused U.S. requests for assistance in decoding the information on the computer tapes.

⁴⁷Some of the former clients for whom Mathewson has provided assistance in obtaining a criminal conviction include: (1) Mark A. Vicini of New Jersey, who had deposited \$9 million into a Guardian account and pleaded guilty to evading \$2.2 million in taxes (U.S. District Court for the Eastern District of New York Case No. CR-97-684); (2) members of the Abboud family of Omaha, Nebraska, who have been indicted for money laundering and fraud in connection with \$27 million in cable piracy proceeds transferred to Guardian Bank (U.S. District Court for the District of Nebraska Case No. 8:99CR-80); (3) Frederick Gipp, a Long Island golf pro who had deposited \$150,000 into a Guardian account and pleaded guilty to tax evasion (U.S. District Court for the Eastern District of New York Case No. CR-98-147-ERK); (4) Dr. Jeffrey E. LaVigne, a New York proctologist who deposited \$560,000 into a Guardian account and who pleaded guilty to evading \$160,000 in taxes (U.S. District Court for the Eastern District of New York Case No. 94-1060-CR-ARR); (5) Dr. Bartholomew D’Ascoli, a New Jersey orthopedic surgeon, who had deposited \$395,000 into a Guardian account and pleaded guilty to evading \$118,000 in taxes (U.S. District Court for the Eastern District of New York Criminal Case No. 98-739-RJD); (6) Michael and Terrence Hogan of Ohio, who had deposited \$750,000 of undeclared income into a Guardian account and pleaded guilty to tax evasion (U.S. District Court for the Southern District of Ohio Criminal Case No. CR-1-98-045); (7) David L. Bamford of New Jersey, who had diverted corporate income into a Guardian account and pleaded guilty to tax evasion (U.S. District Court for the District of New Jersey Case Number 2:98-CR-0712); and (8) Marcello Schiller of Florida who had deposited funds in a Guardian account, pleaded guilty to Medicare fraud, and was ordered to pay restitution exceeding \$14 million (U.S. District Court for the Southern District of Florida Criminal Case No. 1:98-CR-0397).

⁴⁸The Record (Bergen County, N.J.) (8/3/97).

⁴⁹New York Times (8/3/99).

Bank Secrecy. Mathewson first explained why bank secrecy plays a central role in the offshore banking industry. He said that Cayman laws strictly limit government and bank disclosure of bank records and personal information associated with depositors. He said that, in his experience, Cayman bank clients relied on those secrecy laws and believed no one would be able to trace a Cayman bank account or corporation back to them. Mathewson asserted that this secrecy was and still is the basis of the Cayman financial industry, and is protected by Cayman authorities. He indicated that, without this secrecy, he thought there would be no reason for U.S. citizens to establish offshore bank accounts, trusts or corporations in the Cayman Islands and pay the costly fees associated with them.

Mathewson stated at another point that he thought 100% of his clients had been engaged in tax evasion, which was one reason they sought bank secrecy. He pointed out that tax evasion is not a crime in the Cayman Islands; Guardian Bank could legally accept the proceeds of tax evasion without violating any Cayman criminal or money laundering prohibitions; and Cayman law placed no legal obligation on its banks to avoid accepting such deposits.⁵⁰ His analysis of the bank's clients is echoed in statements made on behalf of the Guardian Bank liquidator in a letter warning of the consequences of Guardian computer tapes' remaining in U.S. custody:

“[I]t is quite obvious that the consequences of the seizure of these records by the Federal authorities are potentially very damaging to those of the [Offshore] Bank's clients liable for taxation in the U.S. In the likely event that the Federal authorities share the information ... with the Internal Revenue Service, we would anticipate widespread investigation and possibly prosecution of the [Offshore] Bank's clients.”⁵¹

Subsequent U.S. tax prosecutions against Guardian clients have demonstrated the accuracy of this prediction, establishing that numerous depositors had, in fact, failed to pay U.S. tax on the funds in their offshore accounts.

Guardian Procedures Maximizing Secrecy. Mathewson said that Guardian Bank had complied with Cayman secrecy requirements, and he had designed Guardian Bank policies and procedures to maximize secrecy protections for its clients. He stated, for example, that he had begun by changing the name of the bank from Argosy Bank to Guardian Bank. He indicated that he had selected the name Guardian Bank in part after determining that at least 11 other banks around the world used the word Guardian in their title. Mathewson indicated that he had thought the commonness of the name would help secure Guardian's anonymity or at least make it more difficult to trace transactions related to the bank. He indicated that this was a key concern, because offshore banks in small jurisdictions by necessity conduct most of their transactions through

⁵⁰ Mathewson drew a sharp contrast between the proceeds of tax evasion, which his bank had accepted, and the proceeds of drug trafficking, which his bank had not. He stated that Guardian Bank had refused to accept suspected drug proceeds, and multiple reviews of its accounts by law enforcement had found no evidence of any drug proceeds in the bank.

⁵¹ Johnson v. United States, 971 F. Supp. at 865.

international payment systems and so need to find ways to minimize detection and disclosure of client information.

Mathewson advised that a second set of Guardian procedures designed to maximize client secrecy involved the bank's opening client accounts in the name of shell corporations whose true ownership was not reported in public records. He said that almost all Guardian clients had chosen to open their accounts in the name of a corporation established by the bank. Mathewson explained that Guardian Bank had typically set up several corporations at a time and left them "on the shelf" for ready use when a client requested one.

Mathewson said that Guardian Bank had typically charged \$5,000 to supply a "shelf corporation" to a client and \$3,000 to cover the corporation's first-year management fee, for a total initial charge of \$8,000. He said that clients were then required to pay an annual management fee of \$3,000 for each corporation they owned. He said that these fees represented mostly revenue for Guardian Bank, since, at the time, the only major expense per corporation was about \$500 charged by the Cayman authorities each year for taxes and other fees. He said that many Cayman banks offered the same service, and \$8,000 was the going rate at the time.

According to Mathewson, for an additional fee, Guardian clients could obtain an "aged" shelf corporation. He explained that an aged shelf corporation was one which had been in existence for several years and which either had never been sold to a client or had been sold and returned by a client after a period of time. Mathewson indicated that some clients wanted aged shelf corporations in order to back-date invoices or create other fictitious records to suggest past years of operation. He said that this type of corporation helped Guardian clients with preexisting tax problems to fabricate proof of corporate existence and business activity. Mathewson stated that he and other Cayman bankers would customize these aged shelf corporation to suit a client's specific needs.

In addition to providing a shelf corporation to serve as a client's accountholder, Mathewson stated that Guardian Bank usually provided each client with nominee shareholders and directors to further shield their ownership of the corporation from public records. He explained that Cayman law allowed Cayman corporations to issue a single share which could then be held by a single corporate shareholder. He said that a Guardian subsidiary, such as Fulcrum Ltd., was typically named as the shelf corporation's single shareholder. He said that Fulcrum Ltd. would then be the only shareholder listed on the incorporation papers.

Mathewson said that Guardian also usually supplied nominee directors for the shelf corporation. He explained that Cayman law required only one director to appear on the incorporation papers, allowed that director to be a corporation, and allowed companies to conduct business in most cases with only one director's signature. He said that a Guardian subsidiary called Guardian Directors Ltd. was typically used to provide nominee directors for clients and to manage their shelf corporations. He said that the only director's name that would appear on a shelf corporation's incorporation papers was "Guardian Directors Ltd.," and that only one signature from the subsidiary was then needed to conduct business on the shelf corporation's behalf. That meant,

Mathewson advised, that a client's name need never appear on the shelf corporation's incorporation papers or on any other document requiring a corporate signature; signatures were instead provided by a person from Guardian Directors Ltd. In this way, Mathewson indicated, a client's corporation "could do business worldwide and the US client (beneficial owner) could be confident that his name would never appear and, in fact, he or she would have complete anonymity."

Mathewson explained that, to establish a client's ownership of a particular shelf corporation, Guardian Bank typically used a separate "assignment" document which assigned the corporation's single share from the Guardian subsidiary to the client. He said this assignment document was typically the only documentary evidence of the client's ownership of the shelf corporation. He indicated that the assignment document could then be kept by Guardian Bank in the Cayman Islands, under Cayman banking and corporate secrecy laws, to further ensure nondisclosure of the client's ownership interest.

Mathewson said Guardian Bank usually kept clients' bank account statements in the Cayman Islands as well, again to preserve client secrecy. His written materials state, "No bank statements were ever sent to the client in the United States." Instead, he indicated, a client visiting the Cayman Islands would give the bank a few days notice, and Guardian Bank would produce an account statement for an appropriate period of time, for the client's in-person review and signature during their visit to the bank.

Guardian Use of Correspondent Accounts. Mathewson said Guardian Bank utilized correspondent bank accounts to facilitate client transactions, while minimizing disclosure of client information and maximizing Guardian revenues.

Mathewson noted that, because Guardian Bank was an offshore bank, all of its depositors were required to be non-Cayman citizens. He said that 95% of the bank's clientele came from the United States, with the other 5% from Canada, South America and Europe, which he said was a typical mix of clients for Cayman banks. In order to function, he said, Guardian had to be able to handle foreign currency transactions, particularly U.S. dollar transactions, including clearing U.S. dollar checks and wires. He said that, as a non-U.S. bank, Guardian Bank had no capability to clear a U.S. dollar check by itself and no direct access to the check and wire clearing capabilities of Fedwire or CHIPS. But Guardian Bank had easily resolved this problem, he said, by opening correspondent accounts at U.S. banks.

Mathewson said that, over time, Guardian Bank had opened about 15 correspondent accounts and conducted 100% of its transactions through them. He said, "Without them, Guardian would not have been able to do business." He said that, at various times, Guardian had accounts at seven banks in the United States, including Bank of New York; Capital Bank in Miami; Eurobank Miami; First Union in Miami; Popular Bank of Florida; Sun Bank; and United Bank in Miami. He said Guardian also had accounts at non-U.S. banks, including Bank of Butterfield in the Cayman Islands; Bank of Bermuda in the Cayman Islands; Barclay's Grand Cayman; Credit Suisse in Guernsey; Credit Suisse in Toronto; Royal Bank of Canada in the Cayman Islands; and Toronto Dominion Bank.

Mathewson indicated that Guardian Bank's major correspondents were Bank of New York, First Union in Miami, and Credit Suisse in Guernsey, with \$1 - \$5 million on deposit at each bank at any given time. He said that when Guardian Bank was closed in early 1995, it had a total of about \$150 million in its correspondent accounts. He estimated that, over ten years of operation, about \$300 - \$500 million had passed through Guardian Bank's correspondent accounts.

Mathewson said that Guardian Bank had used the services provided by its correspondent banks to provide its clients with a wide array of financial services, including checking accounts, credit cards, wire transfer services, loans and investments. He wrote, "The bank offered almost any service that a US bank would offer, i.e., wire transfers, current accounts, certificates of deposit, the purchase of shares on any share market in the world, purchase of U.S. treasury bills, bonds, credit cards (Visa), and almost any investment that the client might wish." He explained that, while Guardian Bank itself lacked the resources, expertise and infrastructure needed to provide such services in-house, it easily afforded the fees charged by correspondent banks to provide these services for its clients.

Mathewson said that to ensure these correspondent services did not undermine Cayman secrecy protections, Guardian Bank had also developed a series of policies and procedures to minimize disclosure of client information.

Client Deposits. Mathewson said that one set of policies and procedures were designed to minimize documentation linking particular deposits to particular clients or accounts and to impede the tracing of individual client transactions. He said that Guardian Bank provided its clients with instructions on how to make deposits with either checks or wire transfers.

Client Deposits Through Checks. If a client wanted to use a check to make a deposit, Mathewson said, the client was advised to make the check payable to Guardian Bank; one of Guardian's subsidiaries -- Fulcrum Ltd., Sentinel Ltd., or Tower Ltd.; or the client's own shelf corporation. He said the client was then instructed to wrap the check in a sheet of plain paper, and write their Guardian account number on the sheet of paper. He said that the client account number was written on the plain sheet of paper rather than on the check, so that the account number would not be directly associated with the check instrument used to make the deposit.

Mathewson said that Guardian Bank provided its clients with several options for check payees to make a pattern harder to detect at their own bank. He said that if a check was made out to the client's shelf corporation, the client was advised not to endorse it on the back and Guardian Bank would ensure payment anyway. He said that Guardian would then stamp each check on the back with: "For deposit at [name of correspondent bank] for credit to Guardian Bank" and provide Guardian's account number at the correspondent bank. He noted that this endorsement included no reference to the Cayman Islands which meant, since there were multiple Guardian Banks around the world, the transaction would be harder to trace.

Mathewson said that after Guardian Bank accumulated a number of U.S. dollar checks sent by its clients to the bank in the Cayman Islands, it batched them into groups of 50 to 100 checks

and delivered them by international courier to one of its U.S. correspondent banks for deposit into a Guardian account. He said that the U.S. bank would then clear the client checks using its own U.S. bank stamp, which meant the client's U.S. bank records would show only a U.S., and not a Cayman bank, as the payor. He said the correspondent bank would then credit the check funds to Guardian's account, leaving it to Guardian Bank itself to apportion the funds among its client accounts.

Mathewson explained that Guardian Bank never actually transferred client funds out of Guardian's correspondent accounts to the bank in the Cayman Islands, nor did it create subaccounts within its U.S. correspondent accounts for each client. He said that Guardian Bank purposely left all client funds in its correspondent accounts in order to earn the relatively higher interest rates paid on large deposits, thereby generating revenue for the bank. For example, Mathewson said, a Guardian correspondent account might generate 6% interest, a higher rate of return based on the large amount of funds on deposit, and Guardian Bank would then pay its clients 5%, keeping the 1% differential for itself. He said that Guardian might also transfer some funds to an investment account in its own name to generate still larger revenues for the bank. He said that Guardian Bank had opened investment accounts at 10 or more securities firms, including Prudential Bache in New York, Prudential Securities in Miami, Smith Barney Shearson, and Charles Schwab.

He explained that Guardian did not create client subaccounts or otherwise ask its correspondent banks keep track of Guardian client transactions, since to do so would have risked disclosing specific client information. Instead, he said, transactions involving individual Guardian accounts were recorded in only one place, Guardian Bank's ledgers. He said that Guardian Bank's ledgers were kept electronically, using encrypted banking software that was capable of tracking multiple clients, accounts, transactions and currencies and that ran on computers physically located in the Cayman Islands, protected by Cayman bank secrecy laws.

Client Deposits Through Wire Transfers. Mathewson also described the arrangements for client deposits made through wire transfers. He said that clients were provided the names of banks where they could direct wire transfers for depositing funds into a Guardian correspondent account. He said the wire instructions typically told clients to transfer their funds to the named bank "for further credit to Guardian Bank," and provided Guardian's correspondent account number.

Mathewson said that Guardian Bank had preferred its clients to send wire deposits to a non-U.S. bank, such as Credit Suisse in Guernsey, or the Bank of Butterfield in the Caymans, to minimize documentation in the United States. He said the clients were given Guardian's account number at each of the banks and were instructed to direct the funds to be deposited into Guardian's account, but not to provide any other identifying information on the wire documentation. He said clients were then instructed to telephone Guardian Bank to alert it to the incoming amount and the account to which it should be credited. He said that Guardian Bank commingled the deposit with other funds in its correspondent account, recording the individual client transaction only in its Cayman records.

Mathewson stated that, although discouraged from doing so, some clients did wire transfer funds to a Guardian correspondent account at a U.S. bank. He said that Guardian had also, on occasion, permitted clients to make cash deposits into a Guardian correspondent account at a U.S. bank. In both cases, however, he indicated that the clients were warned against providing documentation directly linking the funds to themselves or their Guardian account numbers. He said that after making a deposit at a U.S. bank, clients were supposed to telephone Guardian Bank to alert it to the deposit and to indicate which Guardian account was supposed to be credited. He indicated that, as a precaution in such cases, Guardian Bank would sometimes wire the funds to another Guardian correspondent account at a bank in a secrecy jurisdiction, such as Credit Suisse in Guernsey, before sending it to the next destination, to protect client funds from being traced.

Mathewson said that, whether a client used a check or wire transfer to deposit funds, if the client followed Guardian's instructions, the documentation at the correspondent bank ought to have contained no information directly linking the incoming funds to a named client or to a specific account at Guardian Bank in the Cayman Islands.

Client Withdrawals. Mathewson next explained how Guardian Bank used its U.S. correspondent accounts to provide its clients with easy, yet difficult-to-trace access to their offshore funds. He described three options for client withdrawals involving credit cards, checks or wire transfers.

Client Withdrawals Through Credit Cards. Mathewson said that Guardian Bank had recommended that its clients access their account funds through use of a credit card issued by the bank, which he described as the easiest and safest way for them to access their offshore funds. He explained that Guardian Bank had set up a program to assign its U.S. clients a corporate Visa Gold Card issued in the name of their shelf corporation. He said that the only identifier appearing on the face of the card was the name of the shelf corporation, imprinted with raised type. He said that the clients were then told to sign the back of the card, using a signature that was reproducible but hard to read. He said that, while some clients had expressed concern about merchants accepting the credit card, Guardian had never experienced any problems.

Mathewson said that Guardian Bank had charged its clients an annual fee of \$100 for use of a Visa card. Mathewson explained that the cards were issued and managed on a day-to-day basis by a Miami firm called Credomatic. To obtain a card for a particular client, Mathewson explained that Guardian Bank had typically sent a letter of credit on behalf of the client's shelf corporation to Credomatic. He said the amount of the letter of credit would equal the credit limit for the particular card. He said that, to ensure payment by the client, Guardian Bank would simultaneously establish a separate account within Guardian Bank containing funds from the client in an amount equal to twice the client's credit card limit. He said these client funds then served as a security deposit for the credit card. He said, for example, if a client had a \$50,000 credit card limit, the security deposit would contain \$100,000 in client funds. He said that, while most of their cardholders had \$5,000 credit limits, some went as high as \$50,000.

Mathewson stated that Credomatic had not required nor conducted background checks on

Guardian's cardholders, because Guardian Bank had guaranteed payment of their credit card balances through the letters of credit, which meant Credomatic had little or no risk of nonpayment. Mathewson stated that Guardian Bank had instructed Credomatic never to carry a credit card balance over to a new month, but to ensure payment in full each month using client funds on deposit at Guardian Bank. In that way, he said, the client funds in the security deposit eliminated any nonpayment risk to Guardian Bank. According to Mathewson, the arrangement was the equivalent of a monthly loan by the bank to its clients, backed by cash, through a device which gave its U.S. banking clients ready access to their offshore funds.

Mathewson observed that Guardian Bank had earned money from the Visa card arrangement, not only through the \$100 annual fee, but also through commissions on the card activity. He explained that once a credit card was issued, Credomatic managed the credit relationship, compiling the monthly charges for each card and forwarding the balances to Guardian Bank which immediately paid the total in full and then debited each client. In return, he said, Credomatic received from merchants the standard Visa commission of approximately 3% of the sales drafts and, because Guardian Bank had guaranteed payment of the monthly credit card balances, forwarded 1% to the bank. He said it was a popular service with clients and profitable for Guardian Bank. In response to questions, he said that, as far as he knew, Credomatic had never questioned Guardian Bank's operations or clients and was "delighted" to have the business. Credomatic is still in operation in Miami.

Client Withdrawals Through Correspondent Checks. Mathewson said that a second method Guardian Bank sometimes used to provide U.S. clients with access to their offshore funds was to make payments on behalf of its clients using checks drawn on Guardian's U.S. correspondent accounts.

Mathewson explained that each correspondent bank had typically provided Guardian Bank with a checkbook that the bank could use to withdraw funds from its correspondent account. He said that the Bank of New York, which provided correspondent services to Guardian Bank from 1992 until 1996, had actually provided two checkbooks. He said the first checkbook from the Bank of New York had provided checks in which the only identifier at the top of the check was "Guardian Bank" -- without any address, telephone number or other information linking the bank to the Cayman Islands -- and the only account number at the bottom was Guardian's correspondent account number at the Bank of New York in New York City. He said the second checkbook provided even less information -- the checks had no identifier at the top at all and at the bottom referenced only the Bank of New York and an account number that, upon further investigation, would have identified the Guardian account. He explained that checks without any identifying information on them were common in Europe, Asia and offshore jurisdictions, and that Guardian Bank had experienced no trouble in using them.

He said that Guardian Bank sometimes used these checks to transact business on behalf of a client -- such as sending a check to a third party like a U.S. car dealership. He said that if the amount owed was over \$10,000, such as a \$40,000 payment for a car, the client would authorize the withdrawal of the total amount of funds from their Cayman account, and Guardian Bank would

send multiple checks to the car dealership, perhaps 5 or 6, each in an amount less than \$10,000, to avoid generating any currency report. He noted that, once deposited, each check would be cleared as a payment from a U.S. bank, rather than from a Cayman bank. He said that if the check used did not have an identifier on top, the payee would not even be aware of Guardian Bank's involvement in the transaction. If traced, he noted that the funds would lead only to the correspondent account held by Guardian Bank, rather than to a specific Guardian client. He said that Cayman secrecy laws would then prohibit Guardian Bank from providing any specific client information, so that the trail would end at the correspondent account in the United States.

Mathewson said that correspondent checks, like the VISA credit cards, gave Guardian clients ready access to their offshore funds in ways that did not raise red flags and would not have been possible without Guardian Bank's correspondent relationships.

Client Withdrawals Through Wire Transfers. A third option for clients to access their offshore funds involved the use of wire transfers. Mathewson explained that Guardian clients had no authority to wire transfer funds directly from Guardian Bank's correspondent accounts, since only the bank itself had signatory authority over those accounts. He said that the clients would instead send wire transfer instructions to Guardian Bank, which Guardian Bank would then forward to the appropriate correspondent bank. He said that Guardian Bank would order the transfer of funds to the third party account specified by the client, without any client identifier on the wire documentation itself, requiring the client to take responsibility for informing the third party that the incoming funds had originated from the client.

Mathewson observed that its correspondent accounts not only enabled its clients readily to deposit and withdraw their offshore funds and hide their association with Guardian Bank, but also generated ongoing revenues for Guardian Bank, such as the higher interest paid on aggregated client deposits, credit card commissions, and wire transfer fees.

Two Other Client Services. In addition to routine client services, Mathewson described two other services that Guardian Bank had extended to some U.S. clients, each of which made use of Guardian Bank's correspondent accounts. Both of these services enabled Guardian clients to evade U.S. taxes, with the active assistance of the bank.

Invoicing. Matheson first described a service he called invoicing, which he said was provided in connection with sales transactions between two corporations controlled by the same Guardian client. He said that a typical transaction was one in which the client's Cayman corporation purchased a product from abroad and then sold it to the client's U.S. corporation at a higher price, perhaps with a 30% markup, using an invoice provided by Guardian Bank. He said that this transaction benefitted the client in two ways: (1) the client's Cayman corporation could deposit the price differential into the client's account at Guardian Bank tax free (since the Cayman Islands imposes no corporate taxes) and, if the client chose, avoid mention of the income on the client's U.S. taxes; and (2) the client's U.S. corporation could claim higher costs and less revenue on its U.S. tax return, resulting in a lower U.S. tax liability.

Mathewson said that the Guardian Bank service had included supplying any type of invoice the client requested, with any specified price or other information. He said Guardian Bank had also made its correspondent accounts available to transfer the funds needed by the client's Cayman corporation for the initial product purchase, and to accept the sales price later "paid" by the client's U.S. corporation. In return for its services, he said, Guardian Bank had charged the client in one of three ways: (1) a fee based upon the time expended, such as \$1,000 for four hours of work; (2) a flat fee for the service provided, such as \$25,000 per year; or (3) a fee based on a percentage of the shipment cost of the product invoiced. Mathewson observed that, at the time, he did not consider this activity to be illegal since, unlike the United States, the Cayman Islands collected no corporate taxes and did not consider tax evasion a crime. However, Cayman authorities told Minority Staff investigators that Guardian Bank's invoicing services were both unusual in Cayman banking circles and a clearly fraudulent practice.

Dutch Corporations. Mathewson advised that Guardian Bank had also assisted a few U.S. clients in obtaining Dutch corporations to effect a scheme involving fake loans and lucrative U.S. tax deductions. He explained that Guardian Bank had begun offering this service after hiring a new vice president who had set up Dutch corporations in his prior employment. Mathewson said, for a \$30,000 fee, Guardian Bank would establish a Dutch corporation whose shares would be wholly owned by the client's Cayman corporation. Mathewson said that Guardian Bank used a Dutch trust company to incorporate and manage the Dutch corporations, paying the trust company about \$3,000 - \$4,000 per year per corporation. He said that Guardian Bank was able to charge ten times that amount to its clients, because the few clients who wanted a Dutch corporation were willing to pay.

Once established, Mathewson said, the Dutch corporation would issue a "loan" to the U.S. client, using the client's own funds on deposit with Guardian Bank. He said the U.S. client would then repay the "loan" with "interest," by sending payments to the Dutch corporation's bank account, opened by the Dutch trust company at ANB AMRO Bank in Rotterdam. He said that the Dutch corporation would then forward the "loan payments" to the client's Guardian account, using one of Guardian Bank's correspondent accounts.

In essence, he said, the U.S. client was using Guardian Bank's correspondent accounts to transfer and receive the client's own funds in a closed loop. He said the benefits to the client were fourfold: (1) the client secretly utilized his or her offshore funds; (2) the client obtained seeming legitimate loan proceeds which could be used for any purpose in the United States; (3) the client repaid not only the loan amount, but additional "interest" to the Dutch corporation, which in turn sent these funds to the client's growing account at Guardian Bank; and (4) if the client characterized the loan as a "mortgage," the client could deduct the "interest" payments from his or her U.S. taxes, under a U.S.-Netherlands tax treaty loophole which has since been eliminated.

Due Diligence Efforts of U.S. banks. When asked about the due diligence efforts of the U.S. banks that had provided correspondent services to Guardian Bank, Mathewson said that he thought the U.S. banks had required little information to open a correspondent account, had

requested no information about Guardian Bank's clients, and had conducted little or no monitoring of the account activity.

Mathewson said the account opening process was "not difficult." He said that, during the ten years of Guardian Bank's operation from 1984 to 1994, U.S. banks wanted the large deposits of offshore banks like Guardian Bank and were "delighted" to get the business. He said it was his understanding that they would open a correspondent relationship almost immediately upon request and completion of a simple form. He said the account was opened within "a matter of days" and apparently with little verification, documentation, or research by the correspondent bank. He could not recall any U.S. based bank turning down Guardian Bank's request for an account, nor could he recall any U.S. correspondent bank officer visiting Guardian Bank prior to initiating a correspondent relationship.

Mathewson also could not remember any effort by a U.S. based bank to monitor Guardian Bank's correspondent account activity. He said, "I don't think any of them ever attempted to monitor the account." He stated that, to his knowledge, Guardian Bank's correspondent banks also had no information related to Guardian's individual clients, since Guardian Bank had designed its procedures to minimize information about its clients in the United States.

An Insider's View. Guardian Bank was in operation for ten years. It had over 1,000 clients and \$150 million in its correspondent accounts when it was closed by the Cayman Government in early 1995. Since then, Mathewson has pled guilty to money laundering, tax evasion and fraud, and has helped convict numerous former bank clients of similar misconduct. He has also provided the most detailed account yet of the operations of an offshore bank.

Mathewson informed Minority Staff investigators that correspondent banks are fundamental to the operations of offshore banks, because they enable offshore banks to transact business in the United States, while cloaking the activities of bank clients.

When asked whether he thought Guardian Bank's experience was unusual, Mathewson said that, to his knowledge, he was "the first and last U.S. citizen" allowed to attain a position of authority at a Cayman bank. He said he thought he was both the first and last, because Cayman authorities had been wary of allowing a U.S. citizen to become a senior bank official due to their vulnerability to U.S. subpoenas, and because he had met their fears of a worst case scenario – he was, in fact, subpoenaed and, in response, had turned over the records of all his bank clients to criminal and tax authorities in the United States. However, in terms of Guardian Bank's operations, Mathewson said that Guardian Bank "was not unusual, it was typical of the banks in the Cayman Islands and this type of activity continues to this day." He maintained that he had learned everything he knew from other Cayman bankers, and Guardian Bank had broken no new ground, but had simply followed the footsteps made by others in the offshore banking community.

The Mathewson account of Guardian Bank provides vivid details about an offshore bank's use of U.S. correspondent accounts to move client funds, cloak client transactions, and maximize

bank revenues. One hundred percent of Guardian Bank's transactions took place through its correspondent accounts, including all of the criminal transactions being prosecuted in the United States. A number of the following case histories demonstrate that Guardian Bank was not a unique case, and that the deliberate misuse of the U.S. correspondent banking system by rogue foreign banks to launder illicit funds is longstanding, widespread and ongoing.

VII. Conclusions and Recommendations

The year-long Minority Staff investigation into the use of international correspondent banking for money laundering led to several conclusions and recommendations by the Minority Staff.

Based upon the survey results, case histories and other evidence collected during the investigation, the Minority Staff has concluded that:

- (1) U.S. correspondent banking provides a significant gateway for rogue foreign banks and their criminal clients to carry on money laundering and other criminal activity in the United States and to benefit from the protections afforded by the safety and soundness of the U.S. banking industry.
- (2) Shell banks, offshore banks, and banks in jurisdictions with weak anti-money laundering controls carry high money laundering risks. Because these high risk foreign banks typically have limited resources and staff and operate in the international arena outside their licensing jurisdiction, they use their correspondent banking accounts to conduct their banking operations.
- (3) U.S. banks have routinely established correspondent relationships with foreign banks that carry high money laundering risks. Most U.S. banks do not have adequate anti-money laundering safeguards in place to screen and monitor such banks, and this problem is longstanding, widespread and ongoing.
- (4) U.S. banks are often unaware of legal actions related to money laundering, fraud and drug trafficking that involve their current or prospective respondent banks.
- (5) U.S. banks have particularly inadequate anti-money laundering safeguards when a correspondent relationship does not involve credit-related services.
- (6) High risk foreign banks that may be denied their own correspondent accounts at U.S. banks can obtain the same access to the U.S. financial system by opening correspondent accounts at foreign banks that already have a U.S. bank account. U.S. banks have largely ignored or failed to address the money laundering risks associated with “nested” correspondent banking.
- (7) In the last two years, some U.S. banks have begun to show concern about the vulnerability of their correspondent banking to money laundering and are taking steps to reduce the money laundering risks, but the steps are slow, incomplete, and not industry-wide.

(8) Foreign banks with U.S. correspondent accounts have special forfeiture protections in U.S. law which are not available to other U.S. bank accounts and which present additional legal barriers to efforts by U.S. law enforcement to seize illicit funds. In some instances, money launderers appear to be deliberately using correspondent accounts to hinder seizures by law enforcement, while foreign banks may be using the "innocent bank" doctrine to shield themselves from the consequences of lax anti-money laundering oversight.

(9) If U.S. correspondent banks were to close their doors to rogue foreign banks and to adequately screen and monitor high risk foreign banks, the United States would reap significant benefits by eliminating a major money laundering mechanism, frustrating ongoing criminal activity, reducing illicit income fueling offshore banking, and denying criminals the ability to deposit illicit proceeds in U.S. banks with impunity and profit from the safety and soundness of the U.S. financial system.

Based upon its investigation, the Minority Staff makes the following recommendations to reduce the use of U.S. correspondent banks for money laundering.

(1) U.S. banks should be barred from opening correspondent accounts with foreign banks that are shell operations with no physical presence in any country.

(2) U.S. banks should be required to use enhanced due diligence and heightened anti-money laundering safeguards as specified in guidance or regulations issued by the U.S. Treasury Department before opening correspondent accounts with foreign banks that have offshore licenses or are licensed in jurisdictions identified by the United States as non-cooperative with international anti-money laundering efforts.

(3) U.S. banks should conduct a systematic review of their correspondent accounts with foreign banks to identify high risk banks and close accounts with problem banks. They should also strengthen their anti-money laundering oversight, including by providing regular reviews of wire transfer activity and providing training to correspondent bankers to recognize misconduct by foreign banks.

(4) U.S. banks should be required to identify a respondent bank's correspondent banking clients, and refuse to open accounts for respondent banks that would allow shell foreign banks or bearer share corporations to use their U.S. accounts.

(5) U.S. bank regulators and law enforcement officials should offer improved assistance to U.S. banks in identifying and evaluating high risk foreign banks.

(6) The forfeiture protections in U.S. law should be amended to allow U.S. law enforcement officials to seize and extinguish claims to laundered funds in a foreign bank's U.S. correspondent account on the same basis as funds seized from other U.S. accounts.

Banking and anti-money laundering experts repeatedly advised the Minority Staff throughout the course of the investigation that U.S. banks should terminate their correspondent relationships with certain high risk foreign banks, in particular shell banks. They also advised that offshore banks and banks in countries with poor bank supervision, weak anti-money laundering controls and strict bank secrecy laws should be carefully scrutinized. The Minority Staff believes that if U.S. banks terminate relationships with the small percentage of high risk foreign banks that cause the greatest problems and tighten their anti-money laundering controls in the correspondent banking area, they can eliminate the bulk of the correspondent banking problem at minimal cost.

*****IT IS ANTICIPATED THAT THE CASE HISTORIES IDENTIFIED IN THE TABLE OF CONTENTS WILL BE ADDED TO THIS WEBSITE SHORTLY. FOR FURTHER INFORMATION, PLEASE CONTACT THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS MINORITY STAFF AT 202-224-9505.*****